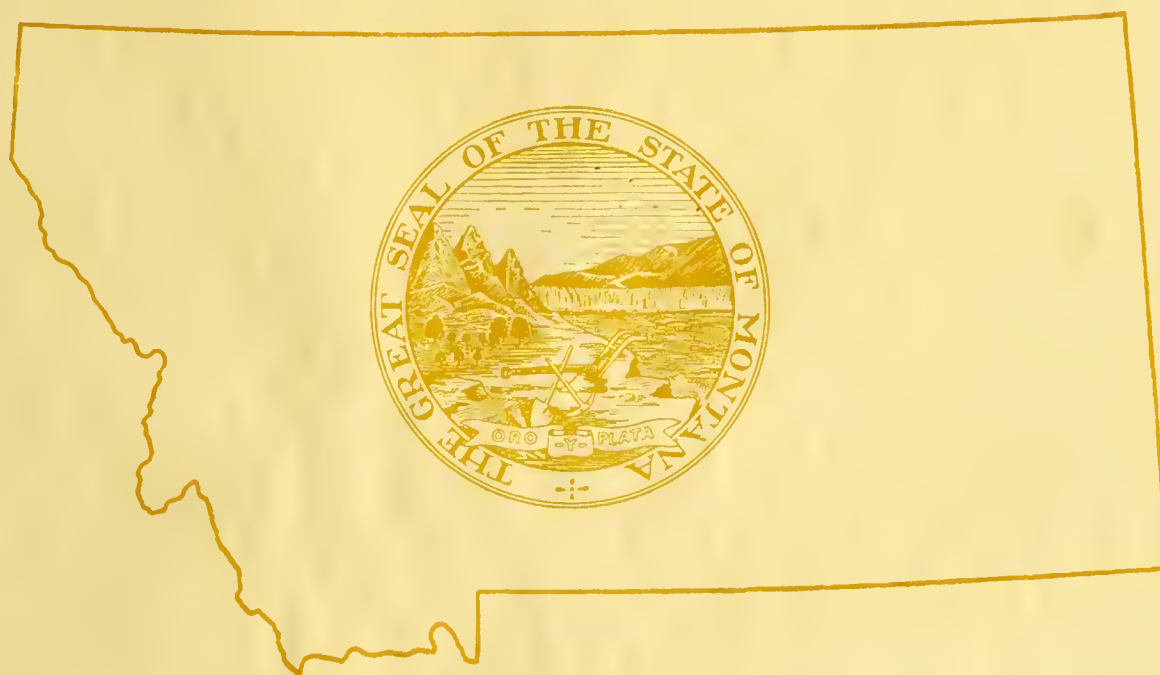


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PROPERTY TAXATION AND THE MONTANA PROPERTY CLASSIFICATION LAW



Montana Legislative Council

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**PROPERTY TAXATION AND
THE MONTANA PROPERTY
CLASSIFICATION LAW**

**A REPORT TO THE THIRTY-NINTH
LEGISLATIVE ASSEMBLY**

by the

Montana Legislative Council

December, 1964



To members of the Thirty-ninth Legislative Assembly:

Taxation is one of the most complex and controversial activities of government. The need for revenues must be balanced against the ability and willingness of people to pay taxes. Taxation must produce sufficient revenue, achieve a reasonable degree of equity, and also be politically acceptable.

Within the field of taxation, one of the most difficult areas is that of property taxation. As explained in this report, property taxation presents unique problems and possibilities for inequities. Moreover, fractional assessments varying between classes of property and the different rates of taxation set by the Montana property classification law make a clear understanding of property taxes difficult for legislators and citizens alike.

The Council hopes that this report will be informative, thus leading to a better understanding of property taxation in the state, and that the recommendations and suggested improvements will lead to more uniformity and equity in property taxation.

Respectfully submitted,

SENATOR W. A. "Bill" GROFF
Chairman
Montana Legislative Council

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1963-1964

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HOUSE JOINT RESOLUTION NO. 16

Introduced by Special Committee On Classification and Appraisal

A JOINT RESOLUTION OF THE SENATE AND HOUSE OF REPRESENTATIVES REQUESTING THAT THE LEGISLATIVE COUNCIL STUDY THE PROPERTY CLASSIFICATION LAWS OF MONTANA, COMPARE THESE LAWS WITH THOSE OF OTHER STATES, AND REPORT ITS FINDINGS AND RECOMMENDATIONS, TOGETHER WITH ANY NECESSARY LEGISLATION, TO THE THIRTY-NINTH LEGISLATIVE ASSEMBLY.

WHEREAS, in 1919 the Montana legislative assembly enacted a property classification law which differentiates among broad classes of real and personal property by means of unequal rates of taxation,

WHEREAS, this law has been amended by seven separate legislative assemblies since its enactment,

WHEREAS, Montana is now one of five states with a comprehensive property classification law,

WHEREAS, in its 1960 report entitled "Property Taxation in Montana," the legislative council reported that "the various classes are not necessarily based on any consistent principle of discrimination," and that "the existence of the law is a temptation to interest groups to reduce their property tax load by securing a more favorable classification from the legislature,"

WHEREAS, the legislative council further stated in its report that "a future legislative assembly should seriously consider the whole question of the classification law."

NOW, THEREFORE, BE IT FURTHER RESOLVED BY THE SENATE AND HOUSE OF REPRESENTATIVES OF THE STATE OF MONTANA:

That the legislative council is requested to study Montana's property classification law, and the classification laws of other states, to determine whether Montana's law is equitable, and if so, whether its administration is in fact resulting in equitable taxation.

BE IT FURTHER RESOLVED, that the legislative council report its findings and recommendations, together with any necessary legislation, to the thirty-ninth legislative assembly.

BE IT FURTHER RESOLVED, that the secretary of state is instructed to send copies of this resolution to each member of the state board of equalization and to the executive director of the legislative council.



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SUMMARY

Property Taxation and the Classified Property Tax

Property taxes may be defined as "taxes conditioned on ownership of property and measured by its value," or as "an annual tax levied on the possessions of the taxpayer." Real property is immovable and includes land, buildings, and permanent improvements. Personal property is generally movable, consisting of tangibles such as inventories, farm crops, machinery, and farm animals and intangible personal property such as stocks, bonds, mortgages, notes and money.

In the opinion of critics, the general property tax has no sound theoretical basis because: (1) it assumes that property possesses the ability to pay taxes even though the income from property may vary; (2) it is a poor measure of benefits received; (3) it is a regressive tax; and (4) it ignores or is poorly correlated with income. The general property tax has also been criticized for lack of uniformity in assessments and various administrative defects.

Property taxation is one of the oldest sources of revenue for government. It was originally a tax upon wealth measured by the ability of the taxpayer. When almost all property consisted of real estate, an assessment measured by real property may have resulted in a tax approximately proportionate to ability to pay. Following their inception, property taxes were subjected to a number of changes which exempted certain types of property, applied special rates to particular types of property, and in some cases extended the property tax to presumed income or ability of the taxpayer.

Property taxes in the American colonies were originally supplementary to the poll tax and to an ill-defined tax on earning capacity usually called "faculty." The tax was not confined to real property, nor even to property as distinct from the taxpayer. The transition from colonial status to statehood resulted in only minor changes in the direction of constitutional provisions for universal and uniform taxation of property. The major concern seems to have been that taxes should be levied only with the consent of the people or their representatives in the legislature. Until about 1860, the trend was toward "equal and uniform" taxation upon all property.

The general property tax is a tax on *all* property regardless of its nature, imposed throughout the taxing jurisdiction at a uniform rate. It is probable that a general property tax has never been achieved in practice. To the degree that the general property tax has not been applied, therefore, some systematic discrimination has existed. At an indeterminate point between complete uniformity and complete exemption, the term "classified" is applied to systems of property taxation. Classification is the grouping of *taxable* objects rather than division of property into taxable and non-taxable groups. Classification has been defined as "the ad valorem taxation of property by its segregation into groups or types and the application to these various classes of different effective rates."

Classification can be achieved through legal means, or through extra-legal classification as the result of administrative procedures and rulings. By either legal or extra-legal means, classification can result from: (1) adoption of different tax rates for various classes of property and the assessment at true value or a uniform percentage of value, (2) fractional assessments to which a uniform ad valorem rate is applied, or (3) assessment at fixed amounts which represent varying percentages of true value and the application of uniform ad valorem rates to these fixed assessments.

Arguments for classification are based upon equity, expediency, or socio-political reasons. Economic differences in property are cited, the impracticality of applying identical taxation methods to dissimilar types of property is noted, or it is asserted that it is desirable to increase or lessen the tax burden upon certain property. For purely practical reasons, classification has been adopted to alleviate the confiscatory exactions made under the general property tax, to increase revenue on some types of property that can be concealed easily, and as a neo-mercantilistic policy designed to retain or attract business.

After 1860, the trend in the United States was toward classification or special treatment of certain classes of property. Administration of the general property tax had proved ineffective, property and property rights were becoming more complex, people began to recognize more clearly the differences in the taxpaying capacity of types of property, and the expanding activities of government increased revenue needs. Few alternative sources of revenue existed prior to 1900, and interest centered on making the property tax produce more revenue and also achieve more equity. By 1940, however, the interest in classification had definitely waned. Progress in administration solved some problems, and the development of other taxes (sales, income, and excise taxes for example) freed state governments from excessive dependence on the property tax for revenue. Rather than a marked change in the classification trend, there has probably been a slow evolution in many states toward withdrawal from property taxation together with increasing exemptions of certain types of property. Only about five states now have comprehensive property classification laws, that of Minnesota being most comparable to the Montana law.

Following several earlier attempts to reform property taxation in Montana, a three member Tax and License Commission recommended a comprehensive classification law to the 1919 legislature. The Commission had found that because of varying assessments Montana had a "sort of classification of property . . . regulated, not by the Legislative Assembly, but by the assessors and the State and County Boards of Equalization." The Commission recommended seven classes of property taxed at from 7 to 100 percent of assessed value. Some of the classifications are more susceptible of explanation than others. The 1919 classification law was, in part, a legalization of the existing extra-legal classification accomplished by fractional assessments, an attempt to distinguish between income and non-income producing property, an attempt to increase tax collections on intangible personal property, and an attempt to tax the mining industry more heavily.

Following passage of the classification law, assessed values increased. Because the classification law reduced values for all but one class, taxable values showed only a slight change. The Tax and License Commission either accurately estimated the amount of under valuation, or local assessors adjusted assessed values so that taxable value would remain almost unchanged under the classification law. The law did not increase tax collections on intangible personal property, and the total impact of the classification law on the tax burden seems to have been slight.

Net Proceeds Taxation of Minerals

One writer has noted that minerals are materially different from other types of property because of the technical difficulty of appraisal and the peculiar problems brought about by the limitation in the useful life of mineral deposits. Petroleum deposits are particularly difficult to value before extraction because the potential of oil fields can be determined only by drilling a well, and even after a discovery the extent and value of a petroleum deposit can only be estimated.

Montana law recognizes the unique nature of mineral deposits and provides for taxation based upon the value of proceeds after the mineral has been extracted rather than taxation of the mineral deposits in place. Extracted minerals are taxable at 100 percent of value after deduction of specified expenses.

Royalty or working interest values are also taxable. Royalties, which are most common in the petroleum industry, usually are payments to the royalty interest owner of twelve and one-half percent of gross production. The royalty interest owner receives a percentage of production without any deduction for expenses of production. In some instances, a royalty interest owner negotiates a working agreement with the producer. Rather than a fixed royalty, he agrees to share in production and also in production expenses.

Reports from mineral producers are submitted directly to the State Board of Equalization and taxable amounts are certified to local assessors for collection of property taxes. The certification sheets show actual production, gross value, claimed deductions, allowed deductions, and net proceeds and royalty interest values subject to taxation. Although the royalty portion of the value subject to taxation belongs to the royalty interest owner, taxes are collected by the producer. The producer acts as a tax collector for the state much like an employer acts as a tax collector by withholding income taxes from employees' salaries. Royalties paid are an allowable item of expense for the producer.

At the invitation of the Council's property classification subcommittee, a number of persons appeared at a public hearing to comment on the classification law. The strongest objections to net proceeds taxation were voiced by representatives of the petroleum industry. These representatives asserted that: (1) the classification law is inequitable, (2) taxing procedures are a "hodgepodge" of sanctioned and unsanctioned extra-legal valuation procedures, (3) the net proceeds law unreasonably overvalues petroleum production, (4) exploration costs are not adequately provided for, (5) the tax is more nearly a gross production than a net production tax, (6) Montana taxes on the petroleum industry are higher than those of any other state except possibly Louisiana, (7) this disparity in taxation discourages exploration and development in Montana, (8) the most important of the several taxes on the petroleum industry is the net proceeds tax, and (9) one of the principal reasons why Montana tax laws do not meet the theoretical test of a reasonable property tax is the present classification law.

It would be extremely difficult, if not virtually impossible, to determine accurately the total taxes paid by the petroleum industry in the state. The Council did, however, compile information on net proceeds property taxes paid on petroleum production. The figures indicate that for each barrel of oil produced in 1963, the average weighted net proceeds tax paid by the producer was 10.99 cents for the entire state. The net proceeds tax, however, is unevenly distributed upon producers and royalty interest owners. The average weighted net proceeds taxes per barrel by county in 1963 varied from none to 18.959 cents. Variations are due to different mill levies and factors relating to value and cost of production for individual producers or oil wells.

Due to the unique conditions in each state or taxing jurisdiction, different approaches to taxation are required. It has been observed that "... a community's tax program, like a suit of clothes, should be tailored to fit the wearer." Not only would a comparison of the total tax burden of the petroleum industry in Montana and other states be costly and time consuming, but there is reason to question the validity of any comparative tax study.

Admittedly, net proceeds of mineral production is taxed at a higher rate in relationship to assessed value than other classes of property. This was the intent of the classification law—discrimination among various classes of property. Deductions are allowed for some expenses, however, and the property is taxed only when income exceeds expenses. All other types of property are taxed each year, and the taxes are applied regardless of whether or not there is any income from the property. The Council concludes, that the contention that net proceeds are overvalued and overtaxed has not been proved.

Representatives of the petroleum industry assert that taxes paid on the royalty interest should be considered in determining the tax burden on the industry. Although the taxes are

paid by the producer, the producer deducts the amount of taxes from the payment made to the royalty interest owner. Moreover, payments to royalty interest owners are an allowable item of expense for the producer. The Council concludes that the net proceeds tax paid on the royalty interest is not a tax burden on the petroleum industry.

Problems Involved In Determining Value For Purposes of Taxation

Because of its importance in property taxation, the term "value" should be precisely and clearly defined, easily understood, and a systematic procedure used to set value for taxation. Unfortunately, the word value has many different meanings.

To fix property values a number of factors may be used, including sales of comparable property, the income which the property will produce, the cost of replacing the property, and others. However, even with these guidelines, the assessor's task is complex. It has been said that *value is opinion only*, based upon consideration of all elements involved in the determination.

If the property is appraised at market value, the assessor may use comparative sales, capitalized income, and replacement cost. It is not difficult to fix the market value if all three approaches yield approximately the same indication of value. A wide disparity, however, might indicate that one method was more valid than the others, and require a decision on the most valid indication of value. Moreover, some properties require different appraisal techniques. Railroads, for example are not often built now, they are seldom sold, and opinions vary regarding the rate of income the property should produce. Obviously, appraisal of railroads requires a modification of usual appraisal techniques.

Montana law requires that all taxable property be assessed at its full cash value. This term has been further defined by law as "the amount at which the property would be taken in payment of a just debt due from a solvent creditor." The definition implies that value is fixed by the current market value of the property.

County assessors and the State Board of Equalization have condoned assessments at less than full market value in Montana. A number of reasons for this situation exist—for example the many fiscal restrictions on local governments based upon assessed and taxable values.

Taxing officials in Montana draw a distinction between the terms "appraised value" and "assessed value." In theory, but not necessarily in fact, the appraised value represents the full value of the property. However, a number of value concepts are employed, including average retail value, average loan value, and dealers cost for inventory. For some types of property such as livestock, the State Board of Equalization has promulgated schedules of value.

After the property is appraised, the value is reduced by various methods to arrive at "assessed value." The assessed value of urban real property is about 40 percent of market value; the assessed value of rural lands is about 20 percent of market value. The Board reduces the appraised value of utilities by a "judgment factor," although the factor has not been explained.

Finally, the percentages specified by the classification law are applied to the assessed value to determine taxable value. Local mill levies are applied to taxable value to compute tax dollars due.

It is apparent that the effect of these methods is to create a classification of property through fractional assessment. This classification is extra-legal, having no statutory basis. Fractional assessments are justified partially by the Board as a means of maintaining equity in taxation.

Property taxes are jointly administered by local officials and the State Board of Equalization. The State Board appraises inter-county property and net proceeds of mines, certifying the value to local officials for tax collections. Although most initial appraisals are made by county assessors and reviewed by county boards of equalization, overall supervision of property taxation is a responsibility of the State Board. The Board performs four primary functions:

- (1) assessment of inter-county property and initial determination of net proceeds valuation,
- (2) supervision of ad valorem taxation at all government levels, (3) review and equalization of assessments, and (4) tax collection.

A possibility for conflict exists between the primary functions of the Board. It may appraise some properties and then sit as a Board reviewing its own actions. Moreover, if directives of the Board are scrupulously observed by county assessors, the Board may in effect, again be reviewing what are essentially its own actions.

The broad powers delegated to the Board have been extended through interpretation of the constitutional phrase giving it the power to "do all things necessary to secure a fair, just and equitable valuation of all taxable property. . ." The Board construes this language as authority to set levels of assessment for classes of property. While assessment levels obviously vary, factual information necessary to measure the degree of variation has not been collected. The "true and full" or market value of each class of property is not known, and the relationship of assessed values to market value is not known. Until information on the actual market value of property is collected, it will not be possible to determine accurately the level of assessment nor the actual discrimination effected by the classification law.

A recent report on property taxation concluded that poor assessment was a condition that no state can afford to tolerate. The state has a number of basic responsibilities for property taxation. Local governmental units are creatures of the state; they derive their taxing powers from the state; and the state has imposed a number of fiscal restrictions on them based in part upon property valuations. Although intended as a means of fiscal control, the measure of assessed value has been called an "erratically elastic standard for measurement purposes." If assessments are not uniform or if general underassessment prevails, clearly no effective control can be exercised by limiting fiscal authority on the basis of property values. If administrative officials control the level of assessment, they also exercise fiscal control over local governments, although this authority rightfully belongs to the legislature.

Although the concept of "value" is nebulous, the term is vitally important for taxation and it should be as precisely and clearly defined as possible. The practice of the State Board of Equalization using different concepts of value, the promulgation of schedules for particular type of property the distinction between "appraised" and "assessed" values, and the general practice of underassessment have resulted in an increased degree of complexity in ad valorem taxation, and have made it difficult for taxpayers to comprehend the workings of tax laws. Until some common concept of value is applied to all property within the state, it will not be possible to measure accurately the degree of discrimination effected by tax laws and administrative procedures.

To enhance the possibility that taxpayers will understand taxation, the Council recommends that the State Board of Equalization be required to gather and publish information on the relationship of assessed values to true and full values for all classes of property. The Council suggests that the ratio established for utilities include information on both the total unit value determined by the Board and the values of locally assessed utility properties by county. The Council also believes that the information compiled by the recent reclassification and reappraisal program will be wasted unless it is kept current.

Property tax administration can and should be improved. It is virtually impossible for the legislature to prescribe assessment standards by statute, but the legislature should create a legal framework which encourages high quality administration.

Miscellaneous Recommendations

A substantial amount of household goods and similar personal property escapes taxation entirely. There is little uniformity in forms used to list such property, and methods of setting value vary among the counties. The tax is difficult to administer effectively at a reasonable cost and probably creates inequities. The Council concludes that present methods could be improved and recommends that the constitution be amended to remove the requirement that this property be subject to ad valorem taxation.

Taxation of moneys and credits presents unique problems for assessors. This type of property is easily concealed, and is highly mobile. Moreover, a determined effort by assessors to discover and assess such property could have the effect of driving it out of the state. It is estimated that less than four percent of moneys and credits are taxed. The low rate of taxation, intended to encourage reporting, has apparently failed. The Council considered several alternative methods for taxing moneys and credits, but each presents problems. The constitutional requirement that moneys and credits be taxed like other property, however, should be removed to allow the legislature discretion in taxing this type of property.

A fixed assessment date for livestock being fed in feed lots presents serious problems for feed lot operators. The operator must cope with varying prices when inventory is purchased, fluctuating costs for feed, an uncertain market price, and rigid standards for each class of livestock demanded by buyers and packers. Obviously, he cannot adjust his inventory on the first Monday in March to reflect accurately the average value of that inventory on a yearly basis. Assessment on an average inventory basis would be more equitable, particularly for the numerous feeders who increase inventories for short periods of time. The Council concludes that a fixed assessment date is inequitable and recommends that this property be assessed on an average inventory basis.

Chapter I

PROPERTY TAXATION AND THE CLASSIFIED PROPERTY TAX

The United States Bureau of the Census defines property taxes as "taxes conditioned on ownership of property and measured by its value."¹ A second definition is "an annual tax levied on the possessions of the taxpayer."²

Two broad, general categories of property are readily distinguishable—real and personal property. The former category is real estate; including land, buildings, and permanent improvements. A distinctive feature of real property is that it is immovable.

Personal property, conversely, is generally movable. Within this category there exists tangible and intangible property. Tangible personal property is that which: (1) directly or indirectly yields a money income such as inventories of all types, farm crops, machinery, and farm animals; and (2) that property which is finally consumed such as household goods and personal effects. Intangible personal property includes claims against tangible wealth such as stocks and bonds, mortgages, promissory notes, money and bank deposits, and the like.³

In the opinion of critics, the general property tax has no sound theoretical basis and is subject to defects:

1. The general property tax adopts a false test of faculty. It assumes that property possesses the ability to pay taxes or is an indication of ability to pay. However, as property becomes productive, men increasingly support themselves from the income and measure taxes in terms of the income out of which they are paid. Property taxes then become assessments upon the return to property, or income taxes. If the property produces no return, however, the tax becomes one on labor to be paid out of the income from services—or it becomes a capital levy destroying a part of the capital. Further, the impermanence of the value of property renders it a precarious standard of measurement. Changes in prices may create fictitious wealth which becomes taxable; or changes may destroy existing values.

2. The property tax is a poor measure of benefits received and cannot be justified under the benefit theory of taxation. If benefits are to be used as a measure of property taxes, however, the benefit must be identifiable and attributable to a specific item of property. Public services are not closely related to local property values, and the benefits are widely diffused. Local political boundaries do not coincide with those which inclose the factors which give value to property.

3. Although the property tax is proportional in form, it is regressive in effect. A proportional tax varies directly in exact ratio to changes in the base, remaining the same percent of the base at all levels. Conversely, a regressive tax becomes a smaller percent of the base as the base is increased. It is asserted that the small property owner pays a larger portion of his income in property taxes than does the large property owner because properties of small value are assessed at a higher ratio to true value than properties of high value.

4. The general property tax ignores, or is poorly correlated with income. This criticism is a corollary of the first defect listed. Property not yielding income is taxable, and some property may be taxed even though its income producing potential is destroyed; for exam-

¹ Frederick L. Bird, *The General Property Tax: Findings of the 1957 Census of Governments*, (1960) p. 1.

² Kenyon E. Poole, *Public Finance and Economic Welfare*, (1957), p. 272.

³ O. H. Brownlee and Edward D. Allen, *Economics of Public Finance*, (1954), p. 335.

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2. The property tax is a poor measure of benefits received and cannot be justified under the benefit theory of taxation. If benefits are to be used as a measure of property taxes, however, the benefit must be identifiable and attributable to a specific item of property. Public services are not closely related to local property values, and the benefits are widely diffused. Local political boundaries do not coincide with those which inclose the factors which give value to property.

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4. The general property tax ignores, or is poorly correlated with income. This criticism is a corollary of the first defect listed. Property not yielding income is taxable, and some property may be taxed even though its income producing potential is destroyed; for exam-

¹ Frederick L. Bird, *The General Property Tax: Findings of the 1957 Census of Governments*, (1960) p. 1.

² Kenyon E. Poole, *Public Finance and Economic Welfare*, (1957), p. 272.

³ O. H. Brownlee and Edward D. Allen, *Economics of Public Finance*, (1954), p. 335.

ple, crops may be destroyed by drought, flood, or other natural disasters. Nor is the income potential of similar property equal. Managerial skill applied to one enterprise may yield a much larger income than that derived from an enterprise with equal property that is poorly managed.

The general property tax also has been criticised severely because of administrative defects:

1. A major complaint has been lack of uniformity in assessment. If the tax is to be universal and applied uniformly throughout a taxing district, it is imperative that assessments be uniform. Obviously the goal of perfectly uniform assessment is difficult, if not impossible, to obtain. Critics basing their arguments upon non-uniform assessments are quick to point out that there is often "competitive underassessment" when taxes are levied for state purposes. Local assessors can reduce the local tax burden for state purposes simply by keeping assessments lower than in other taxing jurisdictions.

2. Another criticism is that through administrative defects many types of property escape taxation. Personal property in general, and particularly intangible personal property, is easily concealed. In a large taxing jurisdiction it is almost impossible for the local assessor to carefully check all types of personal property. Conversely, it is much easier to discover real property. The result is that property taxes rest chiefly upon real property.

3. Critics also assert that even though property taxes are general in theory, in practice property is classified — often through administrative action. This classification is accomplished either through informal agreements between assessors and owners of particular types of property, through agreements among local assessors to value property at specified amounts or percentages, or by administrative action of supervisory groups such as state boards of equalization.

Some of the criticisms are obviously valid. Others may possess varying degrees of validity. One authority has said:

If any tax could have been eliminated by adverse criticism, the general property tax should have been eliminated long ago. One searches in vain for one of its friends to defend it intelligently. It is even difficult to find anyone who has given it careful study who can subsequently speak of its failure in temperate language. We may expect opposition to any tax that produces appreciable revenue. Tirades against taxes constitute an American indoor sport . . . [However,] No writer of repute writing on state and local taxation in the United States has failed to offer his bit of derogatory testimony. No commission appointed to investigate any state tax system, which has had the time, means, and inclination to secure the evidence, has failed to recommend the abolition of the [property] tax or measures tending toward fundamental modification.⁴

Although this statement was made some thirty years ago, it has lost little of its validity today. Much of the criticism of the property tax is directed toward its theoretical basis. The fundamental question then arises: What is the theoretical basis of the property tax? Unfortunately, the question is not susceptible of an easy, simple answer. A brief sketch of the historical development of property taxation, however, may prove helpful.

History of The Property Tax

ORIGINS AND EARLY HISTORY

Property taxation is one of the oldest sources of revenue for government. Its origin can be traced to the beginning of organized society. To provide services to the people, governments needed revenue. This revenue could be obtained only from persons possessing wealth.

⁴Jens Peter Jensen, *Property Taxation in the United States*, (1931), p. 478. Cited hereafter as *Property Taxation*.

The original property tax was, therefore, a tax upon wealth. To determine the amount of the tax, a test of faculty—that is, ability—was applied. In adopting this test, it was assumed that property *per se* possessed the ability to pay taxes, or that the amount of property was an indication of ability. To arrive at an estimate of the ability of a rural resident to pay taxes, it was natural and convenient for the assessor to consider the extent and quality of land holdings and possibly livestock. It was equally natural and convenient to measure the ability of an urban resident by the size or value of the house he occupied.⁵ In a simple economy where almost all property consisted of real estate, an assessment measured by tangible property may have resulted in a tax approximately proportionate to the ability to pay.

Although it is likely that the property tax was originally founded more upon expediency and convenience than upon theory, a tax upon wealth measured by ability to pay could be justified in part upon the benefit theory. A Roman landowner, for example, received protection from plundering by barbarians, a system of roads provided access to market areas for his products, and Roman law protected his property interests. The benefit theory postulates that government confers some benefits on property by public expenditures, and that these benefits not only enhance the value of the property but frequently add to its net return.⁶

Property taxes eventually were subjected to a number of changes and modifications. Generally, the changes exempted certain types of property from taxation, special rates were applied to particular types of property, and the tax was extended in some instances to include considerations other than property such as income from public office, faculty or ability to pay, and others. The property tax system employed in the American colonies was, of course, strongly influenced by the systems used in Europe.

PROPERTY TAXATION IN THE UNITED STATES TO 1860

Not all of tax practices employed in Europe were used in the United States, and few taxes that were adopted have endured to the present time. European influence came indirectly through the tax system of England, but the American tax system is, to a large extent, unique. Property taxation as it exists today in the United States probably never existed in Europe and certainly did not prevail in England at the time of the Revolutionary War.⁷

Property taxes in the colonies were originally supplementary to the poll tax and to an ill-defined tax on the earning capacity of certain persons, usually called "faculty." Nor were property taxes general, that is, uniformly applied to all property. They were frequently imposed only upon selected types of property, and types of property were often accorded arbitrary schedules of statutory values with different rates of taxation applicable to different types of property.⁸

The property tax liability in the American colonies was not confined to real property, nor even to property as distinct from the person of the taxpayer. English tax laws specified the extent to which assessors might use external guides as to the taxpayer's substance and ability. An interpretation of English tax law seems to have been "the land within each parish is to be taxed . . . equally and indifferently, but there may be an addition for the personal visible ability of the parishioners within that parish according to good discretion. . ."⁹

⁵ *Ibid.*, p. 22.

⁶ Simeon E. Leland, *The Classified Property Tax in the United States*, (1928), p. 16. Cited hereafter as *Classified Property Tax*.

⁷ *Property Taxation*, p. 19.

⁸ *Ibid.*, p. 26-27.

⁹ *Ibid.*, p. 20-21.

Prior to 1776, property taxes in Massachusetts applied only to property the legislature included in the lists. Taxes were imposed upon polls, selected types of property, and faculty. In addition to an enumeration of the tax rate on some types of property, New Hampshire schedules contained a listing of persons and things to be "rated by estimation." Connecticut also levied a tax upon faculty or presumptive income. Connecticut laws provided that some "class of laborers, who, by the advantage of their trade, were better able to contribute to the expense of government than common laborers" . . . should be taxed, or listed, for their faculty. Lawyers, for example, were assessed "the least practitioners at fifty pounds and others in proportion to their practice."¹⁰ The property tax was not used widely in the South prior to the Civil War.

The systems used in Pennsylvania, Delaware, and New Jersey were described as follows:

*No objects of taxation are defined or prescribed . . . Legislatures determine the quotas of the towns, which last are apportioned to individuals by assessors; no provision has been made for a disclosure of the property owned by individuals; of course, all assessment by the legislatures, by the supervisors and assessors are determined by a discretionary estimate of the collections and relative wealth of corporations and individuals.*¹¹

From this brief description, it is apparent that property taxes as they existed prior to the Revolutionary War bore very little resemblance to the property tax as it exists today.

The transition from colonial status to statehood resulted in only minor changes in the direction of constitutional provisions for universal and uniform taxation of property. The major concern seemed to be that taxes should be levied only with the consent of the people or their representatives in the legislature.

The new federal government did not levy taxes on property, preferring to rely upon customs duties. Denied custom duties as a source of revenue, the states were forced to rely more and more heavily on other taxes, including those on property. And, as government expenditures increased, property taxes were expanded to include all property. With increases in needs for revenue and possibly under the influence of Jeffersonian democracy a trend away from selective property taxes toward a general tax on all types of property at uniform rates occurred during the period 1800-1860. This trend was clearly evidenced by state constitutional provisions requiring that all real and personal, or simply all property, be taxed according to a uniform rule. Taxation was to be "equal and uniform" upon all property.

Classification of Property

The general property tax is a tax on *all* property regardless of its nature, imposed throughout the taxing jurisdiction at a uniform rate. It is probable that a general property tax has never been achieved in practice. To the degree that the general property tax has not been applied, therefore, some systematic discrimination has existed since the inception of property taxes. It is this departure from uniformity which distinguishes the classified property tax.

At an indeterminate point between complete uniformity and complete exemption of property, the term "classified" is arbitrarily applied to a system of property taxation. The classified property tax has been defined as "the ad valorem taxation of property by its segregation into groups or types and the application to these various classes of different effective rates."¹²

¹⁰ *Ibid.*, p. 28-31

¹¹ *Ibid.*, p. 35.

¹² *Classified Property Tax*, p. 41.

The simplest form of classification, selecting the objects to be taxed, results in two groups of property—taxable and non-taxable. In a strict sense, however, total exemption of certain types of property is not classification. Classification relates to the grouping of *taxable* objects rather than to the division of things to be taxed and things to be exempted.¹³ Legal classification, therefore, can result only from laws which specify that different classes of property shall be taxed at different rates.

Extra-legal classification may be the result of administrative procedures and rulings not based upon statutory authority, or it may be the result of defects in law or of unintended consequences in the application of the law.

METHODS OF CLASSIFICATION

There are three general methods by which classification can be achieved, either through legal or extra-legal means:

(1) *By adoption of different tax rates for various classes of property and the assessment of such property at true value (or at a uniform percentage of true value).* The levies for each class of property may be specified by law. For example, a three mill levy might be applied to moneys and solvent credits. This type of classification requires both a division of property into groups and a schedule of rates or levies differing as between classes of property.

(2) *By the adoption of fractional assessment for various classes of property to which a uniform ad valorem rate is applied.* This is the system employed in Montana where classes of property are taxable at from 7 to 100 percent of true value. Application of the classification law reduces the assessed value. The reason for establishing a system of classification through uniform rates applied to varying percentages of full value might be mainly one of expediency. One writer has suggested that "if legal classification is impossible, illegal or extra-legal classification will be found instead."¹⁴

(3) *By assessments at fixed amounts which represent varying percentages of the true value of the property being taxed, and the application to these fixed assessments of uniform ad valorem rates.* An example of this type of classification might be the assignment of a fixed value to each head of livestock. If the value of two items of property were \$20 and \$30 respectively, but both were assessed at an equal fixed amount, a classification would have been effected.

REASONS FOR CLASSIFICATION

The reasons for classification may be broadly grouped under three general headings: those based upon arguments of equity, those based upon expediency, and those based on socio-political reasons. A rigid separation of the three reasons is not possible, and certain common characteristics may be attributed to each.

Arguments based upon equity point out the economic differences in classes of property. Income from property is selected as the test by which taxes should be determined, and property is therefore a measure of taxable capacity. Economic differences between property classes must be based upon different earning power. Because of these economic differences in property, application of the general property tax results in gross inequities to individual classes of property.

Expediency arguments cite the impracticality of applying identical taxation methods to dissimilar types of property. The application of a uniform tax rate to all property will only result in extra-legal classification through administrative action or evasion. Only through

¹³ *Ibid.*, p. 40.

¹⁴ *Classified Property Tax*, p. 59.

low rates, it is suggested, can listing of all property be achieved voluntarily so the assessor may in good conscience undertake vigorous execution of tax laws. In other words, classification will exist—therefore legalize it.

A third category of arguments cites socio-political reasons for differentiating between classes of property. It is desirable, for one reason or another, to increase or lessen the tax burden upon the owners of certain types of property. The usual objective is to attract new industry to the state, or it may be desirable to stimulate an existing industry in economic difficulty.¹⁵

One writer has enumerated the purely practical reasons for adopting classification as follows:

1. *As a measure of relief from confiscatory exactions made under the general property tax, chiefly on intangibles, upon the relatively few taxpayers who did not practice evasion.*
2. *As a device to increase the revenue from property taxes, chiefly on intangibles, it being hoped that low rates would induce sufficient increases in assessment to maintain or increase the yield; and*
3. *As a neo-mercantilistic policy designed to retain property or business in the state or to attract it, a policy under which selfish interests seeking unwarranted favorable treatment have often masqueraded.*¹⁶

Classified Property Taxes in the United States After 1860

In the United States, the trend until about 1860 was away from the classified property tax and toward a general tax on all types of property at a uniform rate. Following the Civil War, however, the trend was reversed—tending toward classification or special treatment of certain classes of property. This reversal of policy was probably due to three chief factors. Administration of the general property tax had proved ineffective, particularly concerning many types of personal property. All forms of property and property rights were becoming increasingly complex. And, people began to recognize, or rediscover, the differences in the taxpaying capacity of various types of property.¹⁷

In addition, there was the practical consideration that government activities had increased greatly with resulting needs for additional revenue. The Civil War had produced catastrophic economic changes in the nation, particularly in the South. Increased demands for government revenues resulted in sharp increases in the total and per capita property tax collections by state and local governments.

Coupled with the increased needs of government was the growing complexity of property and rights to property. The United States was rapidly becoming a great industrial nation, and wealth was increasingly represented by intangible property such as corporate securities. Intangible property was particularly difficult to discover and assess for taxation purposes.

One further reason for the growing interest in modification of the general property tax should be mentioned. Few alternatives to the property tax were available to state and local governments. Prior to 1900 only one tax which is still a major source of revenue for state governments existed—the death tax. Income taxes, gift taxes, general sales taxes, and excise taxes on liquor, cigarettes, and gasoline did not exist. Given the defects of the general property tax, the need for additional revenue, and the lack of alternatives, it is not surprising that the general property tax was explored with two thoughts: to increase collections and to make it more equitable.

¹⁵ *Classified Property Tax*, p. 115-116.

¹⁶ *Property Taxation*, p. 200-201.

¹⁷ Nevada Legislative Tax Study Group, *Financing State and Local Government in Nevada*, (1960), p. 163.

Pennsylvania, a pioneer in the modern property tax classification movement, adopted a classification law in 1879 fixing the tax levy on personal property at three mills and imposing a corporate loan tax. Connecticut followed in 1899, and in 1901 Alabama adopted a new constitution which was interpreted to allow classification. The following year, 1902, Virginia adopted a constitution which delegated authority to the legislature to classify property for a period of ten years, and in Alabama and New York a mortgage record tax was enacted. In 1906 Minnesota adopted a constitutional amendment allowing classification, and two years later Michigan followed this example. Minnesota and Iowa adopted low tax rates on intangible property in 1911, and Rhode Island began classifying property in 1912. Thus, the movement toward property classification had gained momentum early in the twentieth century.

By 1930 some thirty-one states had acquired the right to classify property. It is probable, however, that property was also classified through various administrative methods in most, if not all, states in varying degrees. Of the thirty-one states that could legally classify property, about twenty-four had actually used this right.¹⁸

Even though thirty-one states had the right to classify property and it may be assumed that some classification existed in all states, by 1930 only four states had adopted comprehensive classification systems—Minnesota, Kentucky, Virginia, and Montana. Ohio adopted a classification law in 1931, and West Virginia passed a classification law in 1933.

By 1940 the interest in classification had definitely waned. In earlier years, classification and separation of sources of state and local revenue were advocated widely. Progress in administration solved some of the property tax problems, and the development of other taxes (sales, income, and excise taxes for example) freed state governments from excessive dependence on the property tax for revenues. Interest became centered on an integration of tax revenues and a division of the receipts between state and local units of governments. By 1940 about forty states had the right to classify, and one authority concludes that when this right became widespread it was natural that the movement to secure the classification privilege should abate.¹⁹ Undoubtedly, thinking on property tax matters was also affected by the depression of the 1930's.

*During the last decade (1930-40) few states, however, abandoned classification. Vermont repealed its intangibles tax law in 1931. Maryland, one of the pioneer states in the low-rate taxation of intangibles, repealed its law as of January 1, 1940. Meanwhile several states have adopted income taxes without repealing the low-rate taxes on intangibles. Nevertheless the interest in classification is not so great as it was ten or twenty years ago.*²⁰

It might be concluded, therefore, that there has been no marked trend in the classification of property since 1930. Rather, there has probably been a slow evolution in many states toward withdrawal from property taxation together with increasing exemptions of certain types of property.

Whether any state which once had a comprehensive property classification law has abandoned classification is to a large extent a matter of definition. For example, one person might consider Kentucky a state which has a comprehensive classification law while another might not. One writer stated: "Montana and Minnesota are the only two states with classified property tax laws of this type. Ohio, Virginia, and West Virginia are not at all comparable."²¹ Thus, due partially to definition of the term, it cannot be stated with certainty that any state has actually abandoned a system of legal comprehensive classification.

¹⁸ *Classified Property Tax*, p. 88-89.

¹⁹ Statements by Simeon E. Leland. Tax Policy League, *Property Taxes*, (1940), p. 83-116.

²⁰ *Ibid.*

²¹ Charles F. Conlon, Executive Secretary of the National Association of Tax Administrators, correspondence to Eugene C. Tidball, May 1, 1963.

Property Classification in Minnesota

Before tracing the history of property classification in Montana, the system used in Minnesota deserves special attention. Minnesota was one of the first states to adopt a comprehensive property tax law, and the Montana Tax and License Commission, which first recommended a property classification law, had "personally visited and conferred with the permanent tax commission in the State of Minnesota, in order to investigate the system prevailing in that state."²² It is likely, therefore, that the recommendations of the commission were influenced by the experience of Minnesota.

The Minnesota classification act grouped property in four classes and specified the percentage of full value which was to be applied to each class. Iron ore, mined or unmined, was placed in class 1, to be assessed at fifty per cent of full value. Household goods, wearing apparel and other similar articles used for domestic purposes were placed in class 2 and assessed at twenty-five percent of full value. Class 3 consisted of personal property such as livestock, tools, machinery, merchandise, logs and lumber, all vehicles and other property of a similar nature in addition to rural, or unplatted, real estate. Class 3 property was assessed at thirty-three and one-third percent of its full value. All other property was placed in class 4 and assessed at forty percent of its full value.²³

The Minnesota Tax Commission gave the following explanation of the classification rates:

*Before this state adopted the so-called classified assessment law there had grown up an almost universal custom of fixing the value on various kinds of properties at different percentages of their true and full value for the purpose of taxation, although the law at that time required all property to be assessed at its true and full value. WHEN THE LEGISLATURE ADOPTED THE CLASSIFIED ASSESSMENT LAW, IT TOOK INTO CONSIDERATION THIS CUSTOM AND MADE THE CLASSIFIED ASSESSMENT LAW TO APPROXIMATELY CONFORM THERETO. (Emphasis supplied.)*²⁴

Property Classification in Montana

Prior to passage of the Montana property classification law in 1919, the statutes required that "all taxable property must be assessed at its full cash value. Land and improvements thereon must be separately assessed."²⁵ Assessments were made by county assessors except for railroad property. The latter, including the franchise, roadway, roadbed, rails and rolling stock were assessed by the State Board of Equalization. In July of each year the county commissioners sat as a county board of equalization with the authority to increase or lower assessments to equalize assessments and make them conform to the true value.

The State Board of Equalization was composed of the Governor, Secretary of State, State Auditor, and Attorney General. The Board had general supervision of all property taxation in the state in addition to the duty to assess the property of railroads and apportion the values among the various local governments. The Board could also review assessments from the counties and make any necessary adjustments to effect equalization. Reports made by the Board during this period suggest that it probably confined its duties almost exclusively to the assessment of railroad property and the apportionment of values to units of local government.

There was considerable interest in tax reform. Governor Edwin L. Norris noted in his messages to the legislature in 1909 and again in 1911 that property in the state was not as-

²² Montana Tax and License Commission, *Report to the State Board of Equalization*, (1917-1918), p. 5. Cited hereafter as *Report*.

²³ Minnesota Tax Commission, *Sixth Biennial Report*, (1918) p. 175.

²⁴ *Ibid.*, p. 56.

²⁵ Section 2502, R.C.M. 1907.

sessed uniformly and that more stringent laws were necessary. In an attempt to correct some of the defects in property tax laws, the 1913 Legislature created a Tax Commission composed of the State Board of Equalization and a tax commissioner to be appointed by the Governor for a six year term.²⁶ In addition to his duties as a member of the State Tax Commission, the Commissioner was ex-officio a member of each county board of appraisers. The county boards were composed of one farmer, one merchant, and one other person appointed by the State Tax Commission.

Although the system may have resulted in some improvements, the results were not entirely satisfactory. Governor Stewart observed in 1915 that the county tax commissioners (boards of appraisers) had not been appointed. In the opinion of the State Tax Commission, the appointment of such a board in each county would have resulted in undue expense and no real benefits would have been realized. Governor Stewart recommended a "suitable constitutional amendment" to correct tax laws.

In 1915 a constitutional amendment was proposed, and subsequently approved in 1916, which amended Section 15 of Article XII of the Constitution to read as follows:

The Board of County Commissioners of each county shall constitute a County Board of Equalization and the Governor, Secretary of State, State Treasurer, State Auditor and Attorney General shall constitute a State Board of Equalization. The duty of the County Board of Equalization shall be to adjust and equalize the valuation of taxable property within their respective counties and all such adjustments and equalization may be supervised, reviewed, changed or decreased by the State Board of Equalization. The State Board of Equalization may adjust and equalize the valuation of taxable property among the several counties and the different classes of taxable property in the same and in the several counties and between individual taxpayers supervise and review the acts of County Assessors and County Boards of Equalization; change, increase or decrease valuations made by County Assessors or equalized by County Boards of Equalization and has such authority and may do all things necessary to secure a fair, just and equitable valuation of taxable property among the counties and between the different classes of property and individuals.²⁷

This amendment considerably enlarged the powers and duties of the Board of Equalization, giving them almost complete authority to regulate and control property taxation in the state.

These measures apparently did not result in the reforms which were intended, however, and criticisms of the Montana property tax continued. In 1918 taxation of property in Montana was described as follows:

Montana has what is commonly known as the General Property Tax. By this we mean that all property is required to be assessed equally, and pay the same rate of taxation . . . It has been generally understood that the Constitution of Montana requires that all property should be taxed on the basis of such an assessment, but in our judgment this understanding is erroneous. The provision with reference to the assessment of property at its full cash value is statutory, and there is nothing in the Constitution which requires taxation on the basis of full cash value. This provision of our statute in regard to the assessment of all property at its full cash value has become a dead letter, not only in Montana, but in every state that has attempted it. Such a provision does not tend to the uniformity in taxation such as is contemplated by our Constitution. Instead of all property in Montana being assessed at its full cash value, we

²⁶ Chapter 75, Laws of 1913.

²⁷ Chapter 47, Laws of 1915.

*find a great lack of uniformity, not only as between different counties but also between individuals, and almost a complete disregard of the statutory provisions relating to full value. About the only properties in Montana assessed at full cash value are the net proceeds of mines and those moneys belonging to widows and orphans and executors of estates which are revealed by court records.*²⁸

Because the attempts at tax reforms had apparently not been judged effective, the legislature established a three member Tax and License Commission in 1917 to study property tax laws and report their findings and recommendations to the 1919 legislature. The Commission was authorized to expend \$25,000 in the conduct of this study. The law required the Commission to

. . . inquire into the assessment and relative amount of taxes paid upon all forms of property in the several counties . . . consult and cooperate with the State Board of Equalization, with a view to gathering evidence and information and making recommendation which will be of assistance to said State Board of Equalization, in the performance of its duties, in securing a fair, just and equitable valuation of taxable property in the State, in adjusting and equalizing the valuation thereof among the several counties, and in raising the necessary revenue for such purposes. . .

During its study, the Commission met often with the Board of Equalization, visited and conferred with the Minnesota Tax Commission, sent one member to a national tax conference, and met with various groups throughout the state. It also compiled a substantial amount of statistical information on property taxation in the state. The Commission, therefore, not only had factual information upon which conclusions could be based, but also expressions of opinion on property taxation from many groups within and without the state.

The Commission report commented on the general property tax in Montana as follows:

*As a matter of fact, our investigations show that land is assessed at about thirty percent of its full value; cattle at approximately forty-five percent; sheep, forty percent; horses and mules, fifty-two percent; hogs, eighteen percent; bank stocks sixty-five percent; and other forms of property at varying percentages. IN THE FACE OF THE POSITIVE STATUTORY ENACTMENT REQUIRING ASSESSMENT AT FULL VALUE, AND IN THE FACE OF INSTRUCTIONS FROM THE ATTORNEY GENERAL THAT THE ASSESSMENT MUST BE MADE IN THAT MANNER, THE ASSESSORS MEET EVERY YEAR, RESOLVE THEMSELVES INTO A SORT OF LEGISLATIVE ASSEMBLY AND PROCEED TO FIX THE VALUES AT WHICH DIFFERENT SPECIES OF PROPERTY SHALL BE ASSESSED. We shall later go more fully into the subject of classification of property, which we believe is authorized by the Constitution. We simply desire at this point to call attention to the fact that WE HAVE A SORT OF CLASSIFICATION OF PROPERTY IN MONTANA REGULATED, NOT BY THE LEGISLATIVE ASSEMBLY, BUT BY THE ASSESSORS AND THE STATE AND COUNTY BOARDS OF EQUALIZATION. We believe a classification should be made by the legislature, and transmit herewith a bill for that purpose. . . It is generally conceded in this state that the present system of taxation is a failure, and results in unjust discrimination and is utterly inadequate. (Emphasis supplied.)*²⁹

Certainly the general property tax did not exist in fact in Montana prior to 1919. In some counties the assessors apparently applied a number of classifications to land while in others no attempt was made to differentiate between land. The report also revealed variation in the assessment of particular items of property even though schedules adopted by the county assessors specified a given amount. In addition, the Board of Equalization had classified at least one type of property—bank stock was assessed at sixty-five percent of its full value—by administrative action. Thus, in Montana a full-blown, extra-legal system of property classification existed.

²⁸ Report, p. 9-10.

²⁹ Report, p. 10-11.

The Tax and License Commission, after commenting upon the extra-legal classification, also noted that the property tax laws failed to reach many types of property. In regard to money and credits, the general property tax law was said to be "almost a total failure." Money and credits were seldom reported for taxation purposes, and when reported they were frequently undervalued. The Commission also noted that mortgages were often taken in the name of non-residents or transferred to banks resulting in considerable evasion for this type of property.³⁰

In its report to the 1919 legislature, the Tax Commission made the following principal recommendations:

1. The establishment of a permanent tax commission to aid and assist county boards of equalization and the State Board of Equalization.
2. A constitutional amendment which would replace the State Board of Equalization with the tax commission and give the commission constitutional status.
3. Extension of the authority of the state taxing authority for assessing public utilities in more than one county.
4. Passage of a classified property law.

These recommendations were accepted although the state taxing authority was called the Board of Equalization rather than tax commission.

Rationale of Classification in Montana

Regarding the Montana property classification law, the Legislative Council recently observed: "... various classes are not necessarily based upon a consistent principle of discrimination."³¹ There were, however, definite objectives when the law was first enacted.

The classes recommended by the Tax and License Commission were:

- Class 1—taxable at 100 percent of true and full value. Net proceeds of all mines and mining claims.
- Class 2—taxable at 20 percent of true and full value. Household goods and furniture, all personal property actually used by the owner for personal and domestic purposes, all agricultural and other tools, machinery, gas and other engines and boilers, threshing machines, automobiles, trucks, vehicles of all kinds, water craft, harness, saddles and robes.
- Class 3—taxable at 33 1/3 percent of true and full value. Livestock, poultry, agricultural products of all sorts, furniture and fixtures used therewith.
- Class 4—taxable at 30 percent of true and full value. All land, town and city lots, improvements on such lands, stock of merchandise, fixtures and supplies except as otherwise provided.
- Class 5—taxable at 7 percent of true and full value. All moneys and credits; including government bonds, warrants and securities but excluding the moneyed capital employed in banking.
- Class 6—taxable at 40 percent of true and full value. Shares of stock in national banks and the capital employed in any banking corporation. The capital was to be determined by deducting from the money and credits the amount of deposits or indebtedness. Value of national bank stock was to be determined by deducting the value of all real estate of such association.
- Class 7—taxable at 40 percent of true and full value. All property not included in the six preceding classes.

³⁰ Report, p. 12.

³¹ Montana Legislative Council, *Property Taxation in Montana*, Report No. 6, (1960), p. 19.

A comparison of the tax rates in Montana prior to classification (effected through fractional assessments), the rates set by the property classification law, and comparable rates in Minnesota and North Dakota at about that time is shown in the table below.

COMPARISON OF TAX RATES FOR VARIOUS TYPES OF PROPERTY
IN MONTANA, MINNESOTA, AND NORTH DAKOTA

Property	RATES (percentage relationship to full value)			
	Montana 1918 a	Montana 1919 b	Minnesota c	North Dakota d
1. Mines, net proceeds.....	100	100	50e	None
2. Land	30	30	33 1/3 - 40	30
3. Livestock	18 - 52	33 1/3	33 1/3	20
4. Household goods	Various	20	10	20
5. Tools and Machinery.....	Various	20	10	20
6. Stocks of merchandise, store fixtures, etc....	Various	33 1/3	33 1/3	20
7. Moneys and credits.....	Unknown	7	f	5
8. Bank stock	65	40	40	20

a. *Report*, p. 10.

b. Taxable rates recommended by the Tax and License Commission and contained in the 1919 property classification law.

c. Rates shown are for 1926. *Classified Property Tax*, p. 228-29.

d. *Ibid.*, p. 243.

e. In Minnesota, mined and unmined ore, rather than net proceeds.

f. Flat rate of three mills on the dollar of valuation.

Some of the similarities in the Montana classification law and those of Minnesota and North Dakota are striking; however, neither system was adopted in total.

Some of the classifications adopted in Montana are more susceptible of explanation than others. A difference of opinion existed on the equity of taxing net proceeds of mines. World War I had brought with it sharp increases in copper prices, and the mines were enjoying a period of prosperity immediately prior to 1919. A senate investigating committee had reported to the 1917 legislature that "the large Mining Companies, the Hydro Electric Companies, the Express Companies, and the Pullman Car Companies are not paying their proportionate share of the State's taxes . . . all these companies are abundantly able to respond to the needs of this State in the matter of revenue without injury to their business or in any manner jeopardizing the general welfare of the people of the state."³²

Moreover, Professor Louis Levine of Montana State University was writing his essay *The Taxation of Mines in Montana*. Professor Levine concluded that the major mining company in the state paid taxes of about six percent of its income derived from operations, while other property, particularly farming property, paid an average of ten to twelve percent of its income from operations in taxes. He advocated assessment of net proceeds of mines at twice or three times their reported value and also changes in the method of allowing deductions from gross proceeds to arrive at net proceeds. Regardless of whether or not the conclusions were correct, many persons accepted them. One writer concluded that ". . . the Montana classified property tax, as well as that of Minnesota, was a direct growth of the debate over mine taxation."³³

³² Montana Senate, *Report of Tax Investigation Committee*, (1917), p. 7.

³³ Warren Aldrich Roberts, *State Taxation of Metallic Deposits* (1944), p. 134.

There may also be an explanation for placing money and credits in Class 5, taxable at 7 percent of value. Charles J. Bullock, professor of economics at Harvard University and a leading authority on property taxation, observed:

Intangible property is easiest of all to conceal or remove from one jurisdiction to another. It can be taxed successfully only by making the rate moderate and uniform throughout the widest possible area . . . intangible property consists of investments from which the owners on an average derive but simple interest; perhaps 5% is a fair average in most parts of the United States. In a reasonable system of classification, then, it would seem that the rate for intangibles should not exceed a figure as the government can collect with reasonable certainty from property that is easily concealed and yields only an income of five percent. Experience shows that from 5 to 6% of the income as a reasonable figure for any tax on intangible wealth; and that taxes exceeding this rate; by causing evasion, are less productive than those which do not exceed it. . . ."³⁴

In summary, it is difficult to attribute specific reasons to the selection of classes of property in Montana. Leland observed that "In some respects the Montana differentiation between types of property is more illogical than those [in Minnesota and Kentucky]. Divisions between some of the classes appear to be without foundation; overlapping is not entirely eliminated; and the entire plan seems too complex."³⁵ He conceded, however, that there were two distinct advantages of the Montana property classification: (1) the low-rate taxation of intangibles, and (2) the taxation of general unproductive property such as household goods at a lower rate than that applied to income-producing property.

³⁴ Charles J. Bullock, "A Classified Property Tax," International Tax Association, *Proceedings of the Third International Conference*, (1909), p. 100.

³⁵ *Classified Property Tax*, p. 256.

Effects of the Montana Property Classification Law

The Montana property classification law set varying rates for property taxation. After assessment, the specified rate is applied to each class to determine the taxable value. The following table shows the effect of the property classification law on assessed values.

ASSESSED VALUES OF PROPERTY IN MONTANA³⁶

1917-1926

(In millions of dollars)

ASSESSMENT BY CLASSES OF PROPERTY								
Year	Total Assessed Valuation	Class 1	Class 2	Class 3	Class 4	Class 5	Class 6	Class 7
		Annual net proceeds of mines	Household goods, agr. implements, Autos, etc.	Livestock, agr. prod., store fixtures, etc.	Real estate and improvements, mfg. machinery, etc.	Money and credits	Nat'l bank stocks; moneyed capital	All other property including public utilities
1917a.....	\$ 582	\$ 45	\$ 18	\$ 86	\$ 318	\$ 9	\$ 13	\$ 90
1918a.....	589	17	24	97	338	8	13	88
1919.....	1,701	3b	66	228	1,044	64	22	267
1920.....	1,668	6	62	182	1,077	63	22	245
1921.....	1,582	4	58	143	1,041	57	20	267
1922.....	1,471	4	49	119	984	50	17	262
1923.....	1,470	10	45	110	971	49	16	272
1924.....	1,397	9	45	104	940	45	11	245
1925.....	1,359	9	49	106	893	43	12	247
1926.....	1,376	17	54	115	884	47	10	240

a. Assessment under general property tax.

b. Decline in assessments due to decline in net income of firms in the copper industry, fall in price of copper, and changes in methods of assessing and computing net proceeds.

As this table shows, the assessed value of property almost tripled under the new classification law.

³⁶ *Classified Property Tax*, p. 251.

More significant was the change in the taxable valuations following the enactment of the property classification law.

TAXABLE VALUES OF PROPERTY IN MONTANA³⁷
1917-1928
(in million dollars)

Year	Total	Class 1	Class 2	Class 3	Class 4	Class 5	Class 6	Class 7
1917.....	582	\$ 51	\$ 18	\$ 89	\$311	\$ 10	\$ 14	\$ 90
1918.....	589	23	24	93	333	9	14	88
1919.....	526	5	13	76	312	5	9	107
1920.....	514	8	12	61	322	4	9	98
1921.....	496	9	12	49	307	4	8	107
1922.....	465	13	10	40	287	4	7	105
1923.....	467	13	9	37	288	3	7	109
1924.....	441	12	9	35	279	3	5	98
1925.....	430	9	10	35	268	3	5	99
1926.....	436	17	11	38	265	3	4	96
1927.....	433	15	12	37	263	4	2	101
1928.....	428	9	13	39	262	3	2	101

A further insight into the effect of the property classification law in Montana is afforded by noting the changes in the percent of total taxable valuations assigned to the various classes.

PERCENTAGES OF TAXABLE VALUATIONS IN MONTANA³⁸
BY PROPERTY CLASS 1917-1926

Year	Class 1	Class 2	Class 3	Class 4	Class 5	Class 6	Class 7
1917.....	8.7	3.2	15.3	53.3	1.6	2.3	15.5
1918.....	3.8	4.1	16.6	56.6	1.5	2.3	15.0
1919.....	0.9	2.5	14.5	59.3	0.9	1.7	20.3
1920.....	1.6	2.4	11.8	62.6	0.9	1.7	19.1
1921.....	1.9	2.4	9.9	61.9	0.8	1.7	21.6
1922.....	2.9	2.1	8.6	61.6	0.8	1.5	22.5
1923.....	2.9	2.0	7.9	61.7	0.7	1.5	23.3
1924.....	2.8	2.1	7.9	63.2	0.7	1.0	22.3
1925.....	2.2	2.3	8.2	62.4	0.7	1.1	23.0
1926.....	4.0	2.5	8.8	60.9	0.8	1.0	22.1

This table indicates at least a part of the effect of the property classification law in Montana. The percent of total taxable value declined for each type of property except classes 4 and 7. The 1919 decline in net proceeds (class 1) resulted from a decline in the price and demand for copper following World War I. It appears that as a result of the classification law, land, town and city lots, improvements on such lands, stocks of merchandise, fixtures and supplies, and the miscellaneous "all other" category including public utilities were bearing a greater part of the property tax burden.

³⁷ State Board of Equalization, *Third Biennial Report*, 1926-28, p. 49.

³⁸ Computed from Taxable Values in Montana 1917-1928 table. Due to rounding, detail does not always add to 100 percent.

The large increase in assessed valuation indicates that the Tax and License Commission was correct in concluding that there was much under valuation in the assessment of property prior to 1919. Assessed values increased, but because of the classification law, taxable values showed only a slight change. The Tax and License Commission either accurately estimated the amount of under valuation, or local assessors adjusted assessed values so that taxable values would be almost unchanged under the classification law. A large part of the decrease in taxable valuation resulted from the post-war depression, and probably reflected the decline in property values rather than any changes effected by the classification law.

Conclusions

The historical background of property taxation and the classification of property lead to the conclusion that the property tax has always been based in part on income. Wealth, represented by property, has been used as an indication of the ability to pay. The general property tax (taxation of all property at a uniform ad valorem rate within the taxing jurisdiction) probably never existed, and certainly did not exist in Montana prior to 1919.

Apparently, the 1919 classification law was, in part: (1) a legalization of the existing extra-legal classification of property; (2) an attempt to distinguish between income and non-income producing property; (3) an attempt to increase tax collections on intangible personal property through a low rate of taxation; and (4) an attempt to tax the mining industry more heavily. The law did not increase tax collections on intangible personal property, and the total impact of the classification law on the tax burden seems to have been slight.

Changes in the property classification law since 1919, and the current law are shown in *Appendix B*.

Chapter II

NET PROCEEDS TAXATION OF MINERALS

After examining the taxation of minerals in the various states, one writer concluded that minerals are materially different from other types of property, and that this difference could well justify taxation on some basis other than the property tax. The significant differences between mineral deposits and other types of property included: (1) the technical difficulty of appraisal; and (2) the peculiar problems brought about by the limitation in the useful life of mineral deposits.¹

The first major problem, therefore, is the determination of value of mineral deposits. Minerals, for the most part, lie under the ground. They are often not uniform in character, and the extent of the deposit and actual value is difficult, if not impossible, to determine prior to extraction. Although the extent and value of many metal mines ore deposits in Montana are known with reasonable certainty, such is not the case in the petroleum industry. Petroleum deposits are more widely dispersed geographically. The exact location and potential of oil fields can be determined only by drilling a well, and the extent and value of the petroleum deposit can only be estimated, even after a discovery has been made.

A second major problem is the unique nature of mineral deposits and the limitation of their useful life. The product of agricultural and timber lands might be maintained indefinitely if proper management methods are employed. In fact, with application of modern technology, the product realized from agricultural and timber property might actually be increased. Mineral deposits, however, can be extracted only once. Once depleted, the mineral is not replaceable.

Taxation of Mineral Deposits in Montana

The Montana constitution and statutes contain special provisions for taxing mineral deposits. Section 3, Article XII of the Montana constitution provides for taxation of the net proceeds of mines rather than taxing the minerals in place, as follows:

All mines and mining claims, both placer and rock in place, containing or bearing gold, silver, copper, lead, coal or other valuable mineral deposits, after purchase thereof from the United States, shall be taxed at the price paid the United States therefor, unless the surface ground, or some part thereof, of such mine or claim, is used for other than mining purposes, and has a separate and independent value for such other purposes, in which case said surface ground, or any part thereof, so used for other than mining purposes, shall be taxed at its value for such other purposes, as provided by law; and all machinery used in mining, and all property and surface improvements upon or appurtenant to mines and mining claims which have a value separate and independent of such mines or mining claims, and *the annual net proceeds of all mines and mining claims shall be taxed as provided by law.* (Emphasis supplied.)

Sections 84-5401 through 84-5415, R.C.M. 1947, provide for the taxation of net proceeds of mines, and sections 84-6201 through 84-6213 cover the taxation of net proceeds of natural gas or petroleum wells. For either type of mineral, the net proceeds subject to taxation are determined by the State Board of Equalization after deduction of allowable costs of production. The allowable deductions are shown in *Appendix C*.

¹ Warren Aldrich Roberts, *State Taxation of Metallic Deposits*, (1944) p. 12.

Reports showing gross value of the product² and an itemized listing of deductions claimed are checked by the State Board of Equalization, and taxable amounts are then certified to the local county assessors who apply state and local mill levies. The taxable value of net proceeds (gross value less deductions) is included within class 1 of the Montana property classification law and taxable at 100 percent of assessed value.

The production from one calendar year is taxed at the mill levies for the following year. After the end of the calendar year, production is reported to the Board of Equalization. Between January 1 and July 1 of the next calendar year, the Board checks the returns and certifies the taxable values to the counties. During August, the mill levies are determined and applied to the net proceeds valuation from the previous calendar year.

If the mineral producing property is not owned by the producer, a royalty payment is made to the royalty interest owner. These royalties, which are most common in the petroleum industry, usually are payments to the land owner of twelve and one-half percent of gross production. The royalty interest owner receives a percentage of production without any deduction for expenses incurred by the producer.

In some instances, a royalty interest owner negotiates a working agreement with the producer. Rather than a fixed royalty payment, he agrees to share in the production and also in the production expenses. For example, a person having a fifty percent working interest in an oil well would receive one-half the gross value of production, but would also incur one-half of the production costs.

When net proceeds values are certified to county assessors, the royalty (or working interest) payments are segregated from the net proceeds value of the producer. The certification sheets show actual production (in tons, barrels, and the like) gross value, deductions claimed by the producer, deductions allowed, net proceeds and royalty interest values subject to ad valorem taxation.

Although the royalty portion of the value subject to taxation belongs to the royalty interest owner, actual taxes are collected by the producer. The producer, therefore, acts as a tax collector for the Board of Equalization much like an employer acts as a federal income tax collector by withholding incomes taxes from employees' salaries. The producer actually collects the tax, makes payment to the state, and then withholds the amount of tax attributable to royalty interest value from payments made to the royalty interest owner.

Objections to Net Proceeds Taxation

To hear testimony of persons associated with mineral extraction industries in the state, the Council's property classification subcommittee held a full day hearing in Billings. A number of representatives of the petroleum and mining industries testified, as did several county officials.

The strongest objections to the net proceeds tax were voiced by representatives of the petroleum industry. Generally, it was asserted that the net proceeds from oil and gas wells is excessively taxed compared to other property in the state, that Montana taxes are higher than in competitive states, and that this excessive taxation makes Montana non-competitive for the oil and gas investment dollar. Specifically, petroleum industry representatives stated that:

1. The classification law is inequitable and the administration of property tax laws, particularly because of current assessment procedures, produces even more inequities.

² Value of the product of metal mines is market value at eastern marketing points for the processed product. The value of petroleum products is the price at the well or posted field price for the unprocessed product.

2. Taxing procedures are a "hodgepodge" of sanctioned and unsanctioned extra-legal valuation procedures varying not only between counties but also within counties.
3. The net proceeds law applied to the petroleum industry unreasonably overvalues production because it creates a taxable value which is an overstatement of net value of production, and the classification law preserves the overstatement while at the same time reducing all other property values for taxation.
4. Exploration costs are not adequately provided for by present allowable deductions.
5. Because the statutes do not provide adequate deductions for many costs of production, the tax is more nearly a gross production than a net production tax.
6. Montana taxes on the petroleum industry are higher than those of any other state except possibly Louisiana. In the Rocky Mountain area, the total tax per barrel in Montana is 22.5 to 24 cents, 10-10.5 cents in Wyoming, 13.7 cents in North Dakota, 13 cents in Colorado, and 14 cents in Utah.
7. This disparity in taxation discourages exploration and development in Montana and diverts investment capital to other Rocky Mountain states.
8. The most important of the several taxes on the petroleum industry in Montana is the net proceeds tax, and it is this tax that makes Montana non-competitive for the petroleum investment dollar.
9. One of the principal reasons why present Montana tax laws do not meet the theoretical test of a reasonable property tax is the present classification law.

In addition to information on total taxes paid compiled by the petroleum industry itself, representatives cited a recent study on the taxation of the petroleum industry by Professor D. H. Harnish of the Montana School of Mines. In that report, Professor Harnish concluded:

... Montana imposes the highest per barrel tax of any of the several major oil producing Rocky Mountain States. It has also been shown that the stripper operation pays a tax rate that could be a contributing cause to premature abandonment of many operations with consequent loss to Montana's economy. It has also been clearly shown that Montana's share of the total oil expenditures in the Rocky Mountain area has dropped from a high of 22% in 1953 to a low of 12% in 1959. . .³

Determination and Evaluation of Net Proceeds Tax Burden

To determine accurately the taxes paid by any economic segment, all taxes must be considered. In Montana, the petroleum industry is subject to corporation income taxes, the oil producers' license tax, oil conservation tax, and ad valorem taxation of net proceeds and other property. It would be extremely difficult, if not virtually impossible, to determine accurately the total taxes paid by the petroleum industry on production in the state. For example, that portion of corporation income attributable to operations in Montana would have to be determined, the amount of income and expense attributable to production, transportation, and refining activities of integrated firms segregated, and a portion of total administrative expense apportioned to Montana operations.

Some taxes paid by the petroleum industry in Montana, however, are more susceptible of measurement. Net proceeds valuations are a fixed amount determined by the State Board of Equalization, and the actual tax dollars paid on net proceeds valuations can be determined

³ D. H. Harnish, *A Comparative Tax Study of Montana's Oil Industry*, (1961), p. 4. Cited hereafter as *Harnish Study*.

by applying local mill levies to these valuations. Although the results do not indicate the total taxes paid, actual tax dollars paid on net proceeds valuations does provide a comparison to various cited figures.

To determine actual net proceeds taxes paid on oil production in Montana, data was compiled showing taxes due in 1963 on production from the calendar year 1962. This information, which is shown in Appendix D, pertains to one year only. Mill levies, and therefore taxes due, may or may not be representative of conditions over a period of years.

Information showing the net proceeds valuation, royalty valuation and total mill levy applied was compiled through a questionnaire to the county assessors.⁴ Data supplied by the county assessors were compared with records of the State Board of Equalization, and any differences reconciled. Valuations of net proceeds were compiled by school district for each county, and taxes due computed by applying the appropriate mill levy. The weighted average tax per barrel by county was computed by dividing the total taxes due in each county by total barrels of production. The state weighted average tax per barrel was computed by dividing total taxes paid in the state by total barrels of production for the state.

Representatives of the petroleum industry do not agree that net proceeds taxes on royalty interest should be deducted to obtain a weighted average net proceeds tax per barrel for oil producers. However, the taxes on royalty interest valuations are not actually paid by oil producers.

Figures shown in *Appendix D* indicate that for each barrel of oil produced in 1963, net proceeds tax paid by the producer was 10.99 cents. This figure compares with estimates varying from 10 to 14 cents per barrel quoted by representatives of the petroleum industry, and an indicated 9.84 cents per barrel tax for "flush" operations and 15.07 cents per barrel for "stripper" operations contained in the Harnish study. The latter figures, however, were computed for hypothetical examples for "flush" and "stripper" operations and cannot validly be compared with figures computed for the industry as a whole.

As the Appendix shows, the net proceeds tax is unevenly distributed upon producers and royalty interest owners in the various counties. The net proceeds tax per barrel of oil produced paid by producers in 1963 varied from none to 18.959 cents per barrel. Royalty interest owners paid up to 5.447 cents net proceeds tax per barrel in that same year. Because of these variations, generalizations on the tax burden are tenuous at best.

The reasons for these variations might be grouped into two broad categories: (1) varying mill levies applied; and (2) factors relating to value of production and costs for individual producers or oil wells. The former category is almost self-explanatory. The mill levies applied to net proceeds valuations varied from a low of 66.5 mills to a high of 150.0 mills during 1963. Obviously, these variations would have a vital effect upon the net proceeds tax per barrel of oil.

The second reason for the variations is related to the economics of production for particular producers or individual oil wells. First, costs of production do not remain a constant percentage of gross value production. It might, for example, cost almost as much to produce 10,000 barrels of oil from a single well as it would to produce 50,000 barrels from another. In fact, it could cost more to produce the 10,000 barrels if complicated recovery techniques were required. Second, depreciation of certain costs is an allowable deduction for a specified period of time—two to ten years, depending upon the depth of the well and option of the producer, in some instances.

⁴ The assistance of Mr. James Patten, Executive Secretary of the Montana Petroleum Association, and county assessors, in compiling this information, is gratefully acknowledged.

Comparative Tax Studies and Industry Location

One of the allegations of representatives of the petroleum industry is that taxes on the industry are higher in Montana than in other states and that this disparity discourages exploration and development in Montana and diverts investment capital to other states. In addressing the National Tax Association in 1961, an economics professor from the University of Colorado observed:⁵

The measurement of comparative state and local tax burdens constitutes one of the more formidable if not wholly intractable tasks in the field of public finance. This is usually recognized by students of taxation despite the fact that special tax committees, industrial development agencies, representatives of business and sundry other special interest groups are continually "proving" that the tax burden in their respective states or communities are either higher or lower than those prevailing elsewhere.

Listed below are some of the reasons why data used in comparative tax studies are not always comparable:

- (1) *A comparative tax study must consider all taxes paid whether state or local. Certainly the exclusion of any tax will distort the picture.*
- (2) *Any comparative tax study must account for the different reliances placed on tax and non-tax revenue sources. In some states, for example, revenue from special assessments, fees, charges, and earnings from government enterprises account for a significant portion of total revenue. In others, these may not be significant.*
- (3) *The comparative tax data collected must be reduced to a common denominator for comparative purposes. This process involves a series of problems.*
 - a) *Examination of each tax in relation to the use of the same tax in another jurisdiction must take careful account of the base provisions. For example, a Colorado study stated that personal income taxes in Colorado were higher than those in North Carolina. While the Colorado rates were higher, Colorado allowed the deduction of federal taxes and North Carolina did not. The effect was that actual taxes paid were lower in Colorado.*
 - b) *Per capita tax burdens must be treated with extreme care. In 1960 state tax collections in Nevada amounted to more than \$157 per capita—a figure 50 percent greater than the average for the nation. This figure, however, did not consider the fact that the state had a population of about 285,000 but accommodated more than 12 million tourists per year, and the fact that 70 percent of the state's total tax revenue was derived from general sales, gasoline, gambling, liquor, and cigarette levies.⁶*
 - c) *Taxes measured in terms of percent of income paid out in taxes are subject to present limitations on comparative income figures. Unfortunately, there is no generally accepted income measure. Personal income figures, where available, are usually restricted to monetary income and exclude other types of income. These figures must be carefully adjusted before any valid conclusions can be drawn from them.*

⁵ Reuben A. Zubrow, "Some Difficulties with Measuring Comparative Tax Burdens," National Tax Association, *Proceedings*, (1961), p. 151 ff. Cited hereafter as *Difficulties*.

⁶ *Difficulties*, p. 151 ff.

- (4) *If a common denominator is to be used for comparative purposes, it appears that actual tax dollars paid represents the best starting point. The compilation of actual tax dollars paid presents a variety of problems.*
 - a) *Statistical data are often impossible to obtain. For example, corporations operating in more than one state must allocate a portion of their income and expenses to a particular state to compute income tax which complicates computation of taxes paid.*
 - b) *Due to the limitations of data from official sources, the information necessary to compute actual tax dollars paid must rely in part upon subjective answers received from the taxpayers.*
 - c) *Determination of property taxes paid presents a whole field of problems in itself. For example, the rate of taxation must be determined by comparing actual tax dollars paid with levels of assessment. Property tax concessions may be granted to new industries, and the mill levies may vary from year to year.*
 - d) *Because most, if not all, actual taxes paid might vary from year to year, it is probable that only by the use of a number of years can the actual true tax rates be determined. Moreover, even this approach must assume that conditions have remained comparable during the period used to average taxes.*
- (5) *Assuming that actual tax dollars paid have been computed, accurately weighted, and made comparable, the different types of taxes must be carefully weighted for comparative purposes. An income tax paid only during those years when income is actually earned is not as onerous as a property tax which must be paid each year regardless of profit.*
- (6) *Actual tax dollars paid must be related to services from government. That is, the cost must be compared with any benefits received.*
- (7) *Adjustments must be made to account for differences in the ability to shift taxes. One writer states, "... It is virtually certain that taxes imposed on businesses in some states are shifted to and ultimately borne by the residents of other states."⁷*

Even if tax burdens between taxing jurisdictions could be compared accurately, there is little apparent correlation between tax burdens and location of industries. A recent survey conducted by the University of South Carolina to determine the factors influencing industrial location concluded:

The replies indicate that manpower considerations are by far the most prominent in location decisions. Various aspects of MANPOWER CHARACTERISTICS were mentioned 47 times in the first 5 items of importance. INDUSTRIAL SITE considerations and transportation requirements were mentioned 34 times among the first five items. LOCAL GOVERNMENT considerations appeared 13 times as did cultural, civic and climatic factors. LEGAL ASPECTS were mentioned 9 times while raw materials and finished goods markets were suggested 7 times each. Community distributing services and money appeared least in importance with only 1 mention each.

Again and again, firms ranked high in importance the ample labor supply of the area, labor cost and availability, the labor climate,—attitude of workers, availability of trainable workers and the like. Transportation facilities, local government (its soundness and cooperation), climatic and civic attractions as well as the good attitudes of local citizens and the labor force were also mentioned by many. The tax structure and utilities also received attention from the firms.⁸

⁷ Robert H. Johnson, "The Reliabilities of Comparative Tax Studies," National Tax Association, *Proceedings*, (1957), p. 74.

⁸ A. C. Flora, Jr., "Industrial Location in South Carolina," University of South Carolina, *Business and Economic Review*, January (1964).

The study concluded that of the twenty-one factors listed on the survey questionnaire, the most significant factors in industry location were amicable labor relations, availability of labor, labor productivity, community attitude, labor laws, and wages. The remaining fifteen factors were mentioned by less than one-half the plant representatives, and the study concluded that these were of secondary importance.

A recent California study showed the relative importance of taxes as compared with other "geographically variable costs." Not all the elements of business costs were shown. Materials, machinery and structures, and other services like insurance were excluded. The chart showed the relative costs as follows:⁹

RELATIVE IMPORTANCE OF GEOGRAPHICALLY VARIABLE
COSTS FOR SELECTED MANUFACTURING INDUSTRIES

(Percent)

	Labor	Freight	Utilities	Taxes	Total
Auto Parts "A".....	68.7	25.9	3.5	1.9	100.0
Auto Parts "B".....	81.6	14.1	2.7	1.6	100.0
Chemical Plant	42.1	40.0	14.0	3.9	100.0
Bldg. Materials	91.0	2.1	4.0	2.9	100.0
Fabricated Steel	49.2	44.0	1.3	5.5	100.0
Hardware	90.3	2.9	5.7	1.1	100.0

This study noted that "It is apparent . . . that state and local taxes constitute a very small percentage of the costs susceptible to geographical variation. In all cases, with the exception of fabricated steel, state and local taxes are less important than the cost of utility services. Thus, for example, in the chemical industry a ten percent differential between two areas in utility services cost would more than offset a 25 percent tax differential in the opposite direction. . ."¹⁰

After conducting a study of the tax position of Washington compared to other states, a long time chairman of the New Jersey tax policy commission and director of Princeton Surveys concluded:

If a technically accurate study shows that business taxes in one state are on the average higher than in another state, it does not necessarily follow:

That business firms will move from the high tax state to the low tax state.

That new business will locate in the low tax state rather than in the high tax state.

That every business located in the low tax state enjoys a tax advantage over comparable businesses in the high tax state.¹¹

Other studies have reached similar conclusions, and it appears that tax differentials among the states are usually not a primary influence upon industrial location. One must also recognize that much of the criticism of high taxes has as its source industries which are pres-

⁹ Jacob A. Stockfish, *A Study of California's Tax Treatment of Manufacturing Industry*, (1961), p. 22.

¹⁰ *Ibid.*, p. 29.

¹¹ John F. Sly, *The Comparative Tax Position of Washington with Other States*, (1957), p. 2.

ently located within a taxing jurisdiction and which, in all probability, will stay there. Comparative tax data are used as evidence to achieve greater net profits for those already here. It may well be that by some standards of equity, some industries are being overtaxed. However, attempts to obtain tax relief by allegations that industry is leaving or refusing to enter the state because of high taxes are often not valid.

Conclusions

The unique conditions pertaining to each state or taxing jurisdiction require different approaches to taxation. Due to these differences, the taxation of any industry or economic segment is most relevant to the taxation of other industries or economic segments within that same state or taxing jurisdiction. It has been observed that "... a community's tax program, like a suit of clothes, should be tailored to fit the wearer."¹² This study has, therefore, been restricted to an examination of the effect of the Montana property classification law on taxation within the state. Although information on the taxation of the petroleum industry in other Rocky Mountain states is of interest, this comparative tax information would be of primary interest only if compared with the taxation of other industries or economic segments within each of the other states. Not only would such a comparison be beyond the scope and capability of the Council at this time, but there is reason to question the validity of any comparative tax study.

Representatives of the petroleum industry object to the inclusion of net proceeds in class 1 of the Montana property classification law—taxable at 100 percent of assessed value. It is asserted that the net proceeds law not only unreasonably overvalues mineral production, but that the classification law preserves the overvaluation while at the same time reducing all other property values for taxation. Admittedly, the net proceeds of mineral production is taxed at a higher rate in relationship to assessed value than other classes of property. This was the intent of the Montana property classification law — discrimination among various classes of property. However, net proceeds is the only class of property in Montana for which deductions are allowable in determining taxable value. Because of the unique nature of mineral deposits and the special formula employed, which in effect transforms an ad valorem tax into a net income tax, comparison with the taxation of other types of property is something like comparing apples and oranges. In addition, the net proceeds tax is applied only once to mineral products, and then only when there is income in excess of allowable expenses. All other types of property in Montana are taxable each year regardless of whether or not there is any income from the property. A farmer, for example, must pay property taxes on his land and equipment each year. Property taxes are due during years when profits are high, and also during years when the farmer might incur a loss on operations. The Council concludes, therefore, that the contention that net proceeds are overvalued and overtaxed has not been proven.

Representatives of the petroleum industry further assert that taxes paid on the royalty interest of mineral production should be considered in determining the tax burden on the industry. Although the net proceeds taxes due on the royalty interest are collected and paid to the state by the producer, the producer deducts the amount of the taxes from payments made to royalty interest owners. Furthermore, the payments made to royalty interest owners are an allowable item of expense in determining the net proceeds value of the producer subject to taxation. After the royalty interest has been determined, the payment made by the producer remains a fixed amount regardless of the level of taxation on the royalty interest. Whether the net proceeds tax on the royalty interest were 5 or 50 percent of value would not affect the producer's costs because the gross royalty payment is fixed by agreement, and any

¹² *Difficulties*, p. 151-52.

taxes collected by the producer are deducted from the payment to the royalty interest owner. The Council concludes that the net proceeds tax paid on the royalty interest is not a tax burden on the petroleum industry.

It is worth mentioning that taxes on a particular industry cannot be measured by using an "average mill levy" as was attempted in the *Harnish* study. The mill levies applicable to oil net proceeds varied from 66.5 to 150.0 mills in 1963. Moreover, production varied from slightly more than 7,000 barrels to almost 7.5 million barrels in the various counties. Obviously, the tax burden can be computed only by a mathematical method which takes account of both varying mill levies and varying production. In computing an average weighted net proceeds tax per barrel of oil, therefore, the Council applied actual mill levies to actual production by school districts.

The average weighted tax per barrel of oil for the state—including both that tax paid by the producer and that paid by royalty interest owners—was 13.18 cents per barrel of oil in 1963. Representatives of the petroleum industry assert that deduction of the net proceeds tax paid by royalty interest owners from total taxes paid, and division of that figure by total barrels of production will not yield a valid indication of the average tax per barrel paid by the producer because the producer does not actually own all the production—a portion belonging to the royalty interest owner. The total weighted tax per barrel of oil paid under the net proceeds law in 1963 was 13.18 cents, however, and a portion of the total net proceeds tax is actually paid by royalty interest owners; therefore producers must pay less than 13.18 cents per barrel net proceeds tax. The term applied to that portion of total net proceeds taxes actually paid by the producer is a problem of semantics, and the Council has no desire to engage in a protracted debate regarding which term should be used. Total actual taxes paid by producers under the net proceeds law in 1963 were \$3.4 million, and division of this figure by total barrels of production yields a figure of 10.99 cents per barrel. The Council therefore, concludes that for each barrel of oil produced in 1963, the oil producers paid an average of 10.99 cents in net proceeds taxes. This figure does reflect a recent change in school financing, and it may or may not be representative of taxes over a period of years.

The average net proceeds tax per barrel of oil produced paid by producers by county varied from none to almost nineteen cents during 1963. The variation is even greater among individual producers. The net proceeds taxes paid by royalty interest owners also varied among counties, and probably also varied within counties.

Although there may be inequities in Montana created by the classification law, the petroleum industry has not presented a convincing argument for a reduction in net proceeds taxation. A reduction in net proceeds taxation would have a marked effect upon finances of some local governments and school districts. Persons who oppose a change in present taxing procedures have pointed out that the entire financial basis for many counties and school districts would be disrupted if changes were made in the present classification law. In support of the contention that present taxing laws are equitable, these persons have pointed out that many services such as schools, roads, and law enforcement were provided to oil companies before any appreciable amounts of taxes were collected under the net proceeds law. It is asserted that although tax dollars collected for any given year may appear high, over a period of time and with consideration of services provided by local governments, the taxation is not excessive.

The dearth of tax data produced by the State Board of Equalization impedes any study of taxation. Rather than evaluate information relating to the state's property classification system, the Council was forced to gather data. The Council was able to determine the figures by obtaining information from both county assessors and from the State Board. The lack of factual information on total taxes paid by the petroleum industry also makes it difficult to reach any firm conclusion regarding the equity of present taxation of mineral deposits under

the net proceeds law. The State Board of Equalization does not compile information on the relationship of taxable value to actual value nor the actual tax dollars paid by economic segments or classes of property. In the absence of this information, the equity of taxation of one economic segment compared with that of another cannot be determined.

The Council further concludes that improvements could be made in administration of the net proceeds tax. The State Board of Equalization does not perform an actual audit of returns submitted by producers, nor are claimed deductions actually verified. Reports are checked for mathematical accuracy, but deductions claimed are not usually questioned unless there is a wide variation from reports previously submitted by the same producer. Neither are returns reconciled with producer reports submitted to the Oil and Gas Conservation Commission. During the years 1958 through 1962, biennial reports of the State Board of Equalization show a variance of 1.1 million barrels of production and \$2.4 million gross value from records of the Oil and Gas Conservation Commission. The discrepancy might be due, in part, to a number of factors. Over a period of years, however, the records of the Board and the Commission should be comparable.

In summary, the Council concludes that: (1) the taxation of one economic segment is most relevant to the taxation of other economic segments within that same state or taxing jurisdiction; (2) there is reason to question the validity of any comparative tax study; (3) the contention that Montana laws unreasonably overvalue mineral production and that the classification law preserves this overvaluation while reducing the value of other property has not been proven; (4) net proceeds taxes paid on royalty interest values are not a tax burden on the petroleum industry; (5) taxes on a particular industry cannot be measured using an "average" mill levy applied to a hypothetical example as was attempted in the *Harnish* study; (6) for each barrel of oil produced in 1963 (which may or may not be representative of taxes over a period of years) the oil producers paid an average of 10.99 cents in net proceeds taxes; (7) due to the variations in mill levies and variations among producers in production and allowable deductions, generalizations based upon this figure are tenuous; (8) although inequities may exist under the present classification law, the petroleum industry has not presented a convincing argument for tax reduction; (9) the lack of information on assessment levels and actual tax dollars paid makes it extremely difficult to reach any firm conclusion on the equity of present taxation of minerals under the net proceeds law, and (10) improvements in the administration of the net proceeds tax should be made.

Chapter III

PROBLEMS INVOLVED IN DETERMINING VALUE FOR PURPOSES OF TAXATION

Concept of Value

The significance of the word "value" to a person engaged in determining taxes to be paid on property would imply that its meaning is precisely and clearly defined, easily understood, and that a systematic procedure is used to determine property values. Unfortunately, such is not the case. In fact, the word "value" has many different meanings. It can mean one thing to an artist, another to a scientist, and something entirely different to an assessor. There is a tendency to interpret value in terms of specific social and economic activities. The assessor thinks in terms of "assessed value," a lending institution uses "loan value" and a broker may use the term "sales value," meaning market value.¹

Since value has several meanings, it is vitally important that its use in taxation be carefully defined. One definition is the relationship between a thing desired and a potential purchaser. Need, for example, gives value to property, but need alone does not confer value.² There are other necessary factors which must also be present. An object must have utility, or it has no value. Even with utility, the object does not have value unless there is scarcity. Air, for example, has the highest utility, but it is not scarce and has no value. Finally, there must be purchasing power present; that is, an individual must have the ability to purchase an item to satisfy his desire.

Rather than a precise definition, an interpretation of value is as follows:

Value is not a characteristic inherent in an object itself, but depends upon the desires of man. It varies from man to man and from time to time as individual desires vary.

An object cannot have value unless it has utility. Utility is the ability to arouse desire for its possession.

Utility alone does not give an object value. It must also be relatively scarce. So utility plus scarcity are two of the elements creating value.

Utility and scarcity together do not confer value unless they arouse desire in the market of a purchaser who has the resources to buy.³

While useful in understanding the term, this interpretation is not of great value to the assessor, and the precise definition remains elusive. To economists, there is little or no distinction between value and price. One value is as fair as any other, and nothing persistently sells for more than it is worth according to economic theory. For the economist, the conclusion is clear that "full, fair cash value" is market price.⁴

The conclusion that value and market price are synonymous in an economic sense, leaves unanswered the question: What is market price? Although the wording may differ slightly, one definition which has evolved from court decisions and from authorities in the field of taxation is:

"Fair market value" is the amount of money for which property may be exchanged within a reasonable time between a seller willing and able but not compelled to sell and a buyer willing and able but not compelled to buy, both having reasonable knowledge of the facts.⁵

¹ American Institute of Real Estate Appraisers, *The Appraisal of Real Estate*, 3rd Ed., (1960) p. 21-22.

² *Ibid.*, p. 23-24.

³ *Ibid.*, p. 25.

⁴ National Tax Association, *Proceedings of the Thirty-Ninth National Conference*, (1946) p. 164. Remarks by Mr. Lynn A. Stiles, Research Supervisor of the Illinois Department of Revenue and lecturer in economics at Roosevelt College of Chicago.

⁵ Connecticut Tax Study Commission, *Property Taxes in Connecticut*, (1959), p. 31.

This definition closely approximates the definition furnished by Mr. Ronald B. Welch of the California Board of Equalization staff to the 1963 Montana House of Representatives Special Committee on Classification and Appraisal. Mr. Welch, a nationally recognized authority on property taxation, said:

*... value for tax purposes means the amount of money or moneys worth which a property would bring if sold to an informed buyer on the first Monday of March after the seller had had the time and exerted the effort to test the market and neither the buyer nor seller were in position to take advantage of the exigencies of the other.*⁶

To fix the value of property for tax purposes, Mr. Welch suggested that the assessor consider all or as many as are pertinent of the following factors:

- a. The prices in any recent sales of the subject property.*
- b. The prices at which other properties of similar character have recently been sold.*
- c. The income which the property is capable of producing under prudent management in its highest and best use.*
- d. The cost of replacing the property with a new property capable of producing the services and amenities which the subject property could produce if new.*
- e. The cost of acquisition of the property by the present or prior owners.*
- f. The loss in value occasioned by physical depreciation and obsolescence.*
- g. The value of shares of stock and liability representing the ownership of and encumbrances on the property.*⁷

However, even with the aid of these definitions and guidelines, the assessor's task remains complex. A method of determining taxable value for one type of property may not be valid for another. Valuation has been termed as much an art as a science. Authorities do not agree on any single definition of the term, and it has been said that *value is opinion only*, based on consideration of all elements involved in the determination.⁸

When property is appraised at market value, there are three generally acceptable indications which may be used. These are income, cost, and comparative sales.

For income producing property, the income approach may provide a good indication of value. Value is determined by dividing the annual income by a percentage figure representing the rate of return normally expected from such property. For example, if a house rented for \$1,000 and the rate of return were determined to be 6 percent, the income approach would indicate a value of \$16,666 (\$1,000 divided by .06). The major question would be determining the rate of return.

A second method of obtaining an indication of value is to estimate the cost of reproducing the property. This gives the appraiser a maximum amount which he cannot exceed in fixing the value of the property.

A third indication of value is comparison of sales of similar property. Historically, this indication of value has been given the top rating as an indication of value. In recent years sales of property which can be used for comparative purposes have been restricted increasingly to residential, farm, and smaller commercial properties. Sales of large commercial en-

⁶ Transcript, Hearing of the Special Committee on Classification and Appraisal (Feb. 3, 1963) p. 1.

⁷ *Ibid.*

⁸ National Tax Association, *Proceedings of the Forty-Sixth Annual Conference*, (1953) p. 193. Statement made by Mr. Joseph P. Sistrich, former assessor of St. Louis, Missouri.

terprises, industrial property, and utilities are almost non-existent or of very little use in determining value. Even when sales of comparable property are available, the assessor must be extremely careful to select sales which are valid and adjust the prices for various factors including time, motive, location, access, and in the case of rural property size, water, topography, and soil.

In the process of assigning value, the assessor may employ all three indications of value. If all three yield a result approximately the same, it is not difficult to assign the value. A wide disparity in the indications obtained, however, might indicate that one method has less validity than the others, and the assessor must then decide which method yields the most valid indication. It is at this point that all his knowledge and experience are used in setting the value.

Some properties cannot be assessed using any one or all of these methods. Railroads, for example, can be assessed on the basis of income, but there are many different views on the rate of return they should earn. Railroads are not often built now, so replacement cost is difficult to obtain. Finally, railroads are not susceptible of being assessed by comparing sales for very obvious reasons. Quite clearly, railroad property is unique and requires a modification of the usual techniques of appraisal. Other utilities present similar problems.

Because of the property classification law, there are two distinct concepts of value for taxation in Montana. Assessed or appraised value is assigned to property as a first step in the taxation process. Taxable value is determined by classifying the property and applying the appropriate percentage.

Montana law requires that all taxable property be assessed at its full cash value.⁹ This term is further defined by law as "the amount at which the property would be taken in payment of a just debt due from a solvent debtor."¹⁰ The meaning of these two statutes is clear. The words "amount at which the property would be taken in payment" imply that value is fixed by the current market value of the property.

All property is not assessed at full cash value in Montana. The Special Committee on Classification and Appraisal of the 1963 House of Representatives stated:

... assessors and taxpayers have merely pretended that assessments have been at full cash value. This was possible because there was no determination of the full cash value of property by which the assessments could be measured. It is no longer possible however, to maintain the pretense, because of the recent appraisals of city and town lots and rural and urban improvements and of the determination of value of agricultural lands. We now have adequate proof that most of the assessments of property in effect prior to the classification and appraisal work were at substantially less than full cash value. We can no longer continue the make-believe of assessing properties at full cash value while in reality assessing them at 20, 30 or 40% of true value. . .¹¹

Assessors, and the State Board of Equalization, condone assessments at less than full value in Montana. Reasons for this underassessment are discussed in Montana Legislative Council *Property Taxation in Montana*, Report No. 6, 1960. Among the reasons for continuation of underassessment are bonding limitations, salaries, and mill levy limits for local governments based upon assessed and taxable value. As the 1963 House Committee on Classification and Appraisal pointed out, it is not feasible to raise all assessments to full market value until appropriate studies can be prepared and adjustments made in fixed mill levies, mill levy limits, bonding limits, salaries, and other elements.¹²

⁹ Section 84-401, R.C.M. 1947.

¹⁰ Section 84-101, R.C.M. 1947.

¹¹ Special Committee on Classification and Appraisal, *Report to the House of Representatives*, (Feb. 5, 1963) p. 7.

¹² *Ibid.*, p. 8.

Underassessment of property in Montana is rationalized by the assessors and the State Board of Equalization by drawing a distinction between the terms "appraised value" and "assessed value." In theory, but not necessarily in fact, the appraised value represents full value of the property. It is immediately apparent that different criteria may be used to determine the value, and the concept of value may differ among assessors.

The State Board of Equalization has issued instructions to local assessors for the appraisal of several types of property using various concepts of value. Some of the concepts are as follows:

1. Trucks and trailers.....Trucks of 1½ tons capacity or less are presumably appraised at *average retail value*. Trucks of more than 1½ tons capacity are appraised by using depreciated *factory price*. Both values are obtained from the truck "Blue Book."
2. Aircraft Based on approximate *current retail value* as shown in Aircraft Blue Book.
3. Automobiles Based on *average loan value* from National Automobile Dealers' Association handbook.
4. Farm equipment Based on *average "as is" value* shown in the Official Tractor and Farm Equipment Guide.
5. Heavy Equipment Based on Idaho schedule.
6. Mobile homes Based on the *base cash value* shown in the Official Mobile Home Market Report.
7. Stocks of merchandise.....Based on *dealers cost for entire inventory*.

Retail and wholesale petroleum dealers' stock; lumber, posts and poles; and livestock are based on schedules furnished assessors by the Board. These definite values have been accepted by the Board upon recommendation of the County Assessors' Association. No mention is made of variations in the values except in the case of livestock. This schedule notes that the values shown are minimums. If no instructions have been issued by the Board, the appraisal method is at the discretion of the local assessor.

Rural lands are also appraised according to a schedule. Values for rural lands are said to be based on "an economic analysis of current net returns to operators." The procedure used for determining income is very complex. Production of all types of land is first converted into hay, the number of livestock which the production would support is computed, a "productivity index" is established, and the assessed value per acre is determined by computations from the productivity index. Several alternative methods are available, and the present figures used are a compromise between several methods which maintain what the Board feels is a correct relationship between various types of land, and classes of land within each type category.

The schedule used for fixing the value of rural lands results in an "assessed" value said to be about 20 percent of market value. The Board has instructed assessors to fix the "assessed" value for urban land and improvements at 40 percent of "appraised" value (roughly equivalent to market value). A reduction of the "appraised" value to obtain an "assessed" value is effected by the use of schedules of value agreed upon by the Board and local assessors for many classes of property.

In appraising utilities, the State Board of Equalization uses the unit rule of appraisal—appraisal of the property as a whole without regard to its constituent parts. This method is used because the individual properties can produce income only if they are parts of a functioning whole. The Board considers three factors: capitalized net earnings, total stock and bond value, and original or reproduction plant cost. The value is generally computed by averaging these three factors. After the total value of the utility in Montana has been set by the Board, the value of locally assessed properties is deducted and the remaining value apportioned to local governments. Regardless of the locally assessed value, therefore, the total value will always equal that set by the Board. For a complete discussion of the method used to value utilities, see *Property Taxation in Montana*, Montana Legislative Council, Report No. 6, 1960.

Finally, the taxable value of property is determined by application of the Montana property classification law to the "assessed" values determined by a variety of methods. Again, the value is reduced in each case except for property in Class 1. The taxable value is multiplied by the mill levy, and taxes due are determined.

The Board reduces values of utilities by a "judgment" factor to obtain an assessed value from the value indicated by application of a formula. Because of general underassessment the Board feels obligated to reduce utility assessments, but the Board has not explained what constitutes this "judgment factor" nor to what it is applied.

It is readily apparent that the effect of these methods is to create a classification of property through fractional assessment. The various concepts and methods used to determine value for different type of property actually result in discrimination effected by assessing techniques. This classification is extra-legal, having no statutory basis. Fractional assessment is justified partially by the Board of Equalization as a means of maintaining equity in the taxation of various types of property.

Property Tax Administration

It is unlikely that equity in taxation and high standards of assessment will be achieved without good property tax administration. Property taxation in Montana is jointly administered by state and local officers. Assessments are reviewed and equalized by county boards of equalization, and appeals may be made to the State Board of Equalization. The State Board of Equalization, however, has final authority for the overall supervision of property taxation.

LOCAL ADMINISTRATION

Although boards of county commissioners can exercise general supervision of property taxation, in practice the assessor is the chief county taxing official. The assessor is a constitutional officer elected for a four year term and needs no qualifications for office other than those for suffrage. He is responsible for the assessment of all property in the county except that assessed by the State Board of Equalization. The assessor is required by law to value property at its "full cash value" and to classify it according to the property classification law.

Article XII, Section 15 of the Montana constitution establishes the board of county commissioners as a county board of equalization and states that the "duties of such board shall be to adjust and equalize the valuation of taxable property. . ." The boards serve three distinct functions which are not clearly distinguished by statute. They review (usually the altering of individual assessments), equalize (change assessment levels of classes of property), and hear taxpayer appeals.

County boards may direct an assessor to list property which has escaped assessment and may add property to the rolls because of false or incomplete statements submitted by taxpayers. The boards may also direct the assessor to cancel entries in his book and substitute new entries "when an assessment made by him is deemed by the board so incomplete as to render doubtful the collection of the tax." All persons affected by these changes must be notified.

STATE ADMINISTRATION

The State Board of Equalization is created by Article XII, Section 15 of the Montana constitution. That section states:

. . . The State Board of Equalization shall be composed of three members who shall be appointed by the governor, by and with the advice and consent of the senate . . . for the term of six years . . . the State Board of Equalization shall adjust and equalize the valuation of taxable property among the several counties, and the different classes of taxable property in any county and in the several counties and between individual taxpayers; supervise and review the acts of county assessors and county boards of equalization; . . . and exercise such authority and do all things necessary to secure a fair, just and equitable valuation of all taxable property among counties, between the different classes of property, between the different classes of property, and between individual taxpayers. . .

The Montana State Board of Equalization performs four primary functions:

- (1) Assessment of inter-county property of utilities and the initial determination of net proceeds valuations;
- (2) Supervision of ad valorem taxation at all government levels;
- (3) Review and equalization of assessments; and
- (4) Tax collection.

It is apparent that a possibility for a conflict exists between the primary functions of the Board. At least the chances are evident for a built-in bias on the part of the Board when reviewing and equalizing assessments; the Board assesses some properties initially, and it may then sit as a board reviewing its own actions. Moreover if Board directives are scrupulously observed by county assessors, the Board may, in effect, again be reviewing what are essentially its own actions.

The Montana constitution directs the Board to assess utility property constituting a single and continuous property operated in more than one county and to apportion values to local governments on a mileage basis. The Board is also responsible for valuing the net mineral proceeds of mines. Reports from producers are submitted directly to the Board, summarily checked for accuracy, and values certified to local county assessors where ad valorem taxes are collected.

The broad powers of the Board have been extended through interpretation of the constitutional phrase delegating power to the Board to "do all things necessary to secure a fair, just and equitable valuation of all taxable property. . ." The Board construes this authority to include setting levels of assessment for classes of property. In spite of the statutory requirement that all taxable property be assessed at its full cash value (implying market value), the practice of general underassessment has prevailed in Montana for many years.

While the level of assessment obviously varies for different classes of property, factual information necessary to measure the degree of variation has not been collected. First, the "true and full" or market value of each class of property is not known. Second, the relationship of assessed values to market values is not known.

Until information on the market value of property is collected, it will not be possible to determine accurately the level of assessment in Montana. The State Board of Equalization can supply figures on the assessment level for some classes of property with acceptable accuracy, but estimates of the assessment levels for many other classes of property are tenuous at best. Due to this lack of information, it is not possible to measure the effect of fractional assessments.

The Board also performs as a tax collector for the state. Among others, the Board collects state income taxes, gasoline taxes, tobacco taxes, death taxes, and various license fees. Although the Board has many duties other than tax collection, most effort is directed toward this area. Of some 114 employees, 107 are directly concerned with tax collection.

Although a valid argument can be made for a quasi-judicial board serving for fixed terms to perform some functions, an administrative body such as the Board of Equalization should be set up to reflect the policies of the chief executive. As a result of the long, fixed terms of Board members, the people of the state have no effective voice in establishing tax policy. As a matter of practice the Board has become a closed corporation and not even the chief executive can effectively influence administration of tax policy.

In summary, the Board of Equalization is an assessing, administrative, and quasi-judicial agency. It is responsible for assessing inter-county utility property and net proceeds of mines, the supervision of county assessors and county boards of equalization, and serves as a board of appeals for property owners dissatisfied with valuations made by counties. The Board is also the principal tax collecting agency of state government.

IMPORTANCE OF GOOD ADMINISTRATION

A recent report by the Advisory Commission on Intergovernmental Relations pointed out the importance of effective assessment administration.

*Good assessment administration, which is fundamental to a good property tax system, is non-existent in many areas. For this reason the property tax is sometimes called the most inefficiently administered tax in the United States. It would be more accurate to say, however, that it has the most uneven quality of administration, for the results range from very satisfactory in some assessment districts, to unbelievably poor in others. Good administration is demonstrably feasible but too often it fails to materialize.*¹³

The report concluded that poor assessment was a condition which no state can afford to tolerate. If state government has created the property tax and placed reliance on it as one of the main components of state-local revenue, the state has responsibility for assuring a uniform, high quality of property taxation. Each state faces a formidable administrative problem—a problem chiefly of organization and personnel. Property tax assessments are a technical administrative function which can be performed only by well-trained specialists using all the appropriate administrative techniques. Two areas which can be improved are: (1) professionalization of the assessment function on a statewide basis, and (2) development of an administrative organization within which the professional staff can work effectively and one which will permit effective statewide coordination and supervision.

The report observed that the solution to organization problems depends on the unique conditions pertaining in each state. In some states, the problem can be resolved merely by refining or perfecting the existing structure. In other states, however, the problem is mainly that of eliminating certain weak features of an otherwise satisfactory system. Some states lack all or most of the principles of good organization, and nothing short of a drastic re-vamping of the existing arrangements would solve their problem.

¹³ Advisory Commission on Intergovernmental Relations, *The Role of the States in Strengthening the Property Tax*, Vol. I, (June 1963) p. 91. Cited hereafter as *Role of the States*.

THE ALTERNATIVES

Three methods of administrative organization for property taxation are:

- (1) Complete centralization;
- (2) Complete centralization of assessment administration with tax collection and enforcement handled locally; and
- (3) Well coordinated joint state-local administration.

The first alternative has been adopted by Hawaii. Some states have considered the second alternative but none has completely accepted it. Joint state-local administration is the procedure used in most states with coordination meeting varying degrees of success.

Complete centralization would place all authority in a state department. State employees would perform initial assessments, compute taxes due, and collect all property taxes. The broad authority of the State Board of Equalization would be extended, and this approach might enhance the possibility of uniform assessment procedures and equity in taxation. More efficient administration could also reduce administrative costs. The office of county assessor would be abolished, and it would be necessary to decide whether tax records should be maintained locally or in a central state office. Taxing jurisdiction boundaries might be changed, or they could remain the same.

Although complete centralization might lead to more uniformity and equity, the degree of improvement would depend largely upon how the laws were administered. The State Board of Equalization now has very broad authority to standardize assessment procedures and insure equalization. It might be questioned whether complete centralization would lead to any marked improvement. It is also doubtful whether there would be substantial savings in administrative costs, and if assessment and taxation procedures remained essentially unchanged, administrative costs might not be reduced.

The second alternative, centralization of assessment with tax collection and enforcement handled locally, has some of the advantages and disadvantages of complete centralization. The degree of centralization is the crucial factor. An extreme example would be the assessment of all property by state employees. Or, state employees might exercise close supervision over local assessors with authority to define methods, review procedures, and change values as deemed necessary. Assessment is the most vital part of the taxation process. If the state either assessed all property or closely supervised local assessors, this approach would not differ essentially from complete centralization.

The third alternative, that of joint state-local administration, is the method employed in Montana. If effective, this method provides uniformity and equity in taxation, the state assumes its responsibility to supervise taxation, and considerable authority is vested in local officials.

Regardless of the approach, the state has a number of basic responsibilities for property taxation. Local governments are creatures of the state; they derive their taxing powers from the state, and the state has imposed a number of financial restrictions upon them, including limiting the mill levies for particular needs, specifying the maximum bonded indebtedness based upon valuations of property, and setting the salaries of local officials based partially upon valuations.

Although intended as a means of regulating the financial policy of local governments, the measure of assessed valuation has been called an "erratically elastic standard for measurement purposes." The Advisory Commission on Intergovernmental Relations observed:

This favored standard has almost unique attributes, in that it has no clear and uniform value to begin with, varies in value from time to time, and varies in value from one local assessing district to another.¹⁴

¹⁴ *Role of the States*, p. 4.

If assessments are not uniform or if general underassessment prevails, as in Montana, clearly no effective control can be exercised by limiting fiscal authority on the basis of property valuations. The bonding limit, tax dollars collected, and salaries of local officials would change drastically if the level of assessment were increased from 50 to 100 percent of true value. Under these circumstances, administrative officials rather than the legislature exercise fiscal control over local governments.

Second, the state levies a property tax at the present time. To achieve justice and equity, assessments must be uniform throughout the state or some taxpayers will be taxed at a higher rate than others for state purposes. And finally, the authority for enacting property tax laws is vested only in the legislative assembly. No level of local government has the authority to legislate in this field.

Conclusions

For various reasons, the practice of general underassessment has prevailed in Montana for many years. Consequently the assessors and Board of Equalization draw a distinction between "appraised" and "assessed" value. Property is first appraised, and this value is then reduced by a number of methods to arrive at assessed value. The classification law is applied to the assessed value to determine taxable value. The result is that property is extralegally classified by fractional assessment and also legally classified under law.

The State Board of Equalization employs several concepts of value including current retail value, average loan value, cash value, dealers' cost of merchandise, factory price, and others. These terms are applied in an apparently arbitrary manner to various types of property. Not only are different concepts of value used, but the initial appraised value is reduced by various methods to obtain assessed value. The result of these procedures is that value can be used only in reference to a specific type of property, and even then the procedure for determining value must be carefully examined if the term is to be understood.

The concept of "value" may be nebulous; certainly the determination of value for ad valorem taxation of property is not an exact science. The term is, however, vitally important to assessing officials and taxpayers of the state, and it should be as precisely and clearly defined as possible.

The practice of the State Board of Equalization of using different concepts of value, promulgation of schedules for particular types of property, distinction drawn between "appraised" and "assessed" values, and the general practice of underassessment have resulted in an increased degree of complexity in ad valorem taxation. Although probably intended as a means of achieving equity in taxation and a degree of uniformity within particular classes of property, the practices may have mitigated against equity and uniformity. Moreover, the procedures make it extremely difficult for taxpayers to comprehend the workings of property taxation.

Because no common concept of value is applied to all property, it is not possible to measure accurately the degree of discrimination between classes of property effected by tax laws and administrative procedures. Nor will measurement be possible until some common standards of assessment to arrive at appraised value are agreed upon by the Board and local assessors, and applied to as many types of property as possible with some degree of uniformity.

To enhance taxpayers understanding of effective rates of taxation and the actual degree of discrimination between different classes of property as a result of fractional assessments, the Council recommends that the State Board of Equalization be required to gather and publish information on the relationship of assessed values to true and full values for all classes of property. The Council suggests that the ratio established for utilities include ratio information on both the total unit value determined by the State Board of Equalization and the

values of locally assessed utility properties by county. For all other classes of property, the information should show the ratio of assessed to true and full values by county for each class or type of property.

The recent reclassification program has produced substantial information on values of real estate. The Council believes that this effort will be wasted unless the information is maintained current and believes that now is an opportune time to expand this information by compiling assessed to full and true value ratios for all property.

The Council also concludes that property tax administration can and should be improved. It has been said that the State Board of Equalization has the power necessary to formulate and enforce sound assessment and taxing procedures. But a simple grant of power is not enough if the administrative organization at each level of government is such that it impedes rather than encourages enlightened administration.

It is possible for the legislature to prescribe assessment standards by statute. But specifying administrative techniques by law is undesirable. The legislature should create a legal framework which encourages high quality administration. Although the enactment of new laws will not guarantee efficiency and equity in the property tax program, a good legal framework enhances the possibility of effective administration.

Chapter IV

MISCELLANEOUS RECOMMENDATIONS

Household Goods and Furniture, Wearing Apparel, and Similar Personal Property

Household goods and furniture, wearing apparel, and similar personal property are included in class two of the property classification law and are taxed at twenty percent of assessed value. Although local assessors have authority to assess and verify self-listings of this type of personal property, the listing supplied by the taxpayer is usually accepted.

A substantial amount of this property probably escapes taxation entirely. Some taxpayers are not carried on assessment lists; in some instances only a portion of total property is reported. Moreover, forms for listing this property are not uniform, and varying methods are employed by county assessors to fix values. Because varying forms and assessment methods are used, the actual value of household goods and similar property is unknown. Nor is it possible to estimate the variation of levels of assessment among counties.

Although actual value is unknown, assessed and taxable values are reported by the State Board of Equalization. In the fiscal year ending June 30, 1963, assessed value for this class of property was about \$71 million; taxable value (twenty percent of assessed value) was about \$14 million. Based upon these figures, estimated taxes levied on this class of property in fiscal 1963 were \$1.5 to \$2.1 million—about two percent of total property tax collections.

The major defects in taxing household goods and similar property in Montana include: (1) some persons escape taxation entirely because they are not listed on assessment rolls; (2) it is virtually impossible for assessors to check the property of each person and consequently self-listing forms are relied upon heavily; (3) partial listing may be widespread; (4) non-uniform listing forms and methods of fixing value probably result in many inequities; and (5) even if all such property were reported, it is extremely difficult to assign values to used furniture and wearing apparel.

Household goods and similar property in other states are taxed in a variety of ways. Twenty-one states have exempted this property from ad valorem taxation, although the Utah exemption applies to furniture only. In addition, eighteen states grant an exemption up to a fixed dollar amount of value. One exemption, however, applies only to persons with incomes under a stated amount or persons receiving public assistance. The deduction of \$5,000 valuation allowed in two states could have the effect of complete exemption, depending upon the relationship of assessed to true value. Three states grant exemptions at local option.

Alternative methods of taxing household goods and similar property include:

1. *Complete exemption from ad valorem taxation.* This approach would reduce assessed valuations in the state by about \$71 million, and taxable valuations by about \$14 million. Taxes collected would be \$1.5 to \$2.1 million less. The varying effect upon individual counties cannot be measured. Based upon 1960 census information, the average assessed valuation of household goods and similar property varied from about \$150 to \$690 per household unit in Montana counties. The unweighted average assessed valuation per household unit for the state was \$355. Because assessed valuations vitally affect county finances, total exemption might also result in increased taxes on other property in the counties. Complete exemption would simplify administrative procedures and would reduce administrative costs.

2. *Exemption of a specified dollar amount of valuation.* This approach would reduce the tax base in proportion to the exemption allowed. Few, if any, administrative problems would be solved.
3. *Taxation at a flat rate per household unit.* Although this approach would simplify administration, the tax might be regressive. The effect upon tax collections would depend upon the rate fixed.
4. *Valuation in relation to the value of real property.* For rental property, the value could be fixed in relation to the real property value or in relation to rent paid by the tenant. This alternative could simplify administration. The effect upon the tax base and tax collections would depend upon the rate specified.

The Council concludes that a substantial amount of household goods and similar property escapes taxation entirely. There is little uniformity in forms used for listing such personal property, and methods of setting value vary among the counties. The tax is difficult to administer effectively at a reasonable cost and probably creates inequities. Although this subject was not studied in sufficient depth to allow specific recommendations to change the method of taxation, the Council concludes that present methods could be improved. As a first step the Council recommends that the constitution be amended to remove the requirement that this property be subject to ad valorem taxation like other property in order to give the legislative assembly discretion to specify the method of taxing this property. A proposed constitutional amendment appears in Appendix E.

Moneys and Credits

The term "moneys and credits" used in Montana statutes and the term "solvent credits" used in biennial reports of the State Board of Equalization are apparently considered synonymous. For the assessor, the terms include individually owned cash, stocks, bonds, and accounts receivable. This property is included in class five of the classification law and is taxable at seven percent of assessed value.

Taxation of moneys and credits presents unique problems to local assessors. Although money on deposit in banks can be verified readily, it is virtually impossible to discover stocks, bonds, and other types of moneys and credits. The property is easily concealed and is highly mobile. Moreover, a determined effort by assessors to discover and assess such property could have the effect of driving it out of the state. In fact, some banks now observe a noticeable decrease in deposits near assessment date. The total assessed value of all solvent credits in the fiscal year ended June 30, 1963 was \$64 million according to the biennial report of the State Board of Equalization.

At the end of 1963 the Superintendent of Banks reported about \$820 million in deposits in Montana banks owned by individuals, of which about \$450 million was in demand deposits (checking accounts), and about \$372 million in time deposits. Cash on deposit in state chartered building and loan associations and credit unions at the end of 1963 was about \$90 million. Cash on deposit in federally chartered savings and loan associations and credit unions, however, is not known. The Savings Bond Division of the U. S. Treasury Department estimates \$172.5 million in federal savings bonds owned by Montana residents. Based upon information from the Internal Revenue Service, U. S. Department of Commerce, and rates of return reported by Moody's Investors Service, it can be roughly estimated that Montana residents owned between \$458 and \$950 million in stocks.¹ No estimates of bonds other than federal savings nor of accounts receivable are possible.

¹ Reported income from dividends by the Internal Revenue Service and Department of Commerce vary widely. Moody's Investors Service reported average yields from stock at 3.2 to 5.3 percent in 1962. Estimates of stocks owned were obtained by dividing reported incomes by an assumed 4 percent rate of return. No estimates of bonds other than federal savings nor of accounts receivable are possible.

It is apparent that taxation of moneys and credits in Montana is not effective. Based upon the figures above, it can be estimated that less than four percent of this type of property is reported to assessors. Although the property classification law sets a low rate of taxation on moneys and credits to encourage reporting, this approach has apparently failed.

Twenty-six states exempt this class of property from taxation, four exempt particular types or grant an exemption to a fixed amount of value, five apply special rates of taxation, four grant a partial exemption and also apply special rates, and eleven apply ad valorem taxation, although the property may be classified as in Montana. Opinions of state taxing officials differ regarding the equity and feasibility of applying ad valorem taxation to moneys and credits. Opinions also vary on whether ad valorem taxation is feasible at a reasonable administrative cost.

The Council considered several alternatives to ad valorem taxation of moneys and credits. Each alternative considered, however, poses problems. Complete exemption would simplify property tax administration greatly. It would also narrow the tax base. Although the immediate effect of complete exemption might not be drastic, problems could arise in the future because wealth is increasingly represented by intangible personal property such as stocks and bonds.

The state could also continue to tax moneys and credits like other property and give taxing officials access to information on state individual income tax returns to help verify reporting. This approach might be detrimental to income tax administration by encouraging non-reporting, however, and it might also encourage removal of moneys and credits from the state. If either happened, this approach could create more problems than were solved.

Moneys and credits could also be exempted to a fixed amount of value. The present low rate of taxation, however, apparently has not resulted in better reporting. A partial exemption would further complicate administration, and it is doubtful that reporting would be encouraged.

The Council concludes that taxation of moneys and credits could be improved, but has not reached a conclusion on how this can best be accomplished. The rigidity effected by the constitutional requirement that moneys and credits be taxed like other property, however, should be removed to allow the legislature discretion in taxing this type of property. It is recommended that the constitution be amended to remove the requirement that moneys and credits be taxed like other property, and that discretion in taxing this property be vested in the legislative assembly. A proposed constitutional amendment appears in Appendix F.

Feeder Livestock

A fixed assessment date for livestock in feed lots presents serious problems for feed lot operators. The feed lot operator must cope with varying prices when inventory is purchased, fluctuating costs for feed, an uncertain market price when livestock are sold, and rigid standards for each class of livestock demanded by buyers and packers. Obviously, he cannot adjust his inventory on the first Monday in March to reflect accurately the average value of that inventory on a yearly basis. Many feeders cannot regulate their inventory to achieve a small value on assessment date as can some other businessmen. Assessment on an average inventory basis would be more equitable, particularly for the numerous feeders who increase inventories sharply for short periods of time. If the assessment date coincided with an operator's high inventory, a marked inequity could result. Moreover, taxes may represent a larger portion of total costs of production for a livestock feeder than for many other economic segments. Livestock feeding margins are narrow and have tended to become even narrower in recent years.²

² Montana State College, Cooperative Extension Service, *The Economics of Cattle Feeding*, Special Report No. 1, September 1961, p. 49.

The Council concludes that assessment of livestock being fed in feed lots on a fixed assessment date is inequitable. Assessment of feeder livestock on an average inventory basis would be more equitable, and it might also encourage expansion of this economic segment. The Council recommends that laws be amended to allow assessment of feeder livestock on an average inventory basis rather than on a fixed date. A bill effecting this proposal appears in Appendix G.



APPENDIXES





APPENDIX A

Glossary of Technical Terms

Taxable Value	Value of property to which mill levies are applied to compute actual tax dollars due. In Montana, the percentage of assessed value computed by applying the classification law.
Taxing Jurisdiction	A geographic area within which uniform rates of taxation apply. In Montana special improvement districts, school districts, municipalities, counties, and the state make up separate taxing jurisdictions.
Working Agreement	As used in the petroleum industry, a joint agreement between two or more parties to share in production and also in production expenses. One of the parties may be a royalty interest owner.

APPENDIX B

Changes In The Property Classification Law Since 1919

Since it was first enacted in 1919, the property classification law has been amended as follows:

- 1921: To net proceeds of mines in class one was added the right to enter upon land to explore or prospect or dig for oil, gas, coal or mineral where the surface title to land passed to another.
- 1929: Moneyed capital and shares of both national and state banks were made taxable at 30%.
- 1937: "All office and hotel furniture and fixtures" were placed in class three (33 1/3%). Added to class five (7%) were "all poles, lines, and other property used and owned by cooperative rural electric associations organized under the laws of Montana."
- 1941: The property of cooperative rural electrical associations in class five was explicitly declared to include "transformers, transformer stations, meters, tools, improvements, machinery."
- 1947: Grains, hay, and vegetables on the farm or in storage awaiting processing were explicitly excluded from class three (33 1/3%) and placed in class five (7%). The inclusion of office and hotel furniture in class three was changed to office "or" hotel furniture.
- 1951: Unprocessed products of livestock and poultry were explicitly included in class three. The inclusion of grain, hay, and vegetables in class five was changed to "All unprocessed agricultural products either on the farm or in storage irrespective of whether said products are owned by the elevator, warehouse or flour mill owner or company storing the same, or by any other person whomsoever, and excepting livestock and poultry and unprocessed products of both." Industrial property, normally included in class four, was placed in class five for a period of three years after such property is first assessed.
- 1957: Cooperative rural telephone associations were included in class five. The provision for inclusion of new industrial property in class five for three years was deleted. Bank surplus up to the amount of stated capital was changed to 7%. Moneyed capital and shares of banks and surplus in excess of stated capital were retained at 30%.¹
- 1961: Class 4 was amended to include "and all trailers affixed to land owned, leased, or under contract of purchase by the trailer owner"; a new paragraph defining Class 7 was added, and former Class 7 was redesignated Class 8.

¹ Bank stock and moneyed capital taxed under a special section, 84-308, R.C.M. 1947.

APPENDIX C

Allowable Deductions

Metal Mines

All royalty paid or apportioned in cash or in kind by the person, corporation or association so engaged in mining.

All money expended for necessary labor, machinery and supplies needed and used in the mining operations and developments.

All money expended for improvements, repairs and betterments necessary in and about the working of the mine, except as hereinafter provided.

All moneys expended for costs of repairs and replacements of the milling and reduction works used in connection with the mine.

Depreciation in the sum of six percent (6%) of the assessed valuation of such milling and reduction works for the calendar year for which said return is made.

All moneys actually expended for transporting the ores, and mineral products or deposits from the mines to the mill or reduction works or to the place of sale, and for extracting the metals and minerals therefrom, and for marketing the product and the conversion of the same into money.

All moneys expended for fire insurance and workmen's compensation insurance, and for payments by mine operators to welfare and retirement funds when provided for in wage contracts between mine operators and employees.

In computing the deductions allowable for repairs, improvements and betterments to the mine, the state board of equalization shall compute and allow ten percent (10%) of such cost each year for a period of ten (10) years.

Petroleum or Natural Gas

Same a

Same

Same b

No provision

. . . cost of drilling wells completed during the period and for other capital expenditures . . . ten percent (10%) of such cost each year for a period of ten (10) years, provided, however, the operator or producer may elect to amortize the cost over a period of two (2) years if the well is less than three thousand (3,000) feet deep. . .

No provision. (The value of metals is determined by the price received at eastern marketing points for the processed product. The value of petroleum products is determined by the price at the well—or posted field price—for the unprocessed product.)

Same c

See depreciation provision above.

- a. Statutes applying to petroleum or natural gas wells read "by the person so engaged" rather than "by the person, corporation or association" as shown above for mines.
- b. Statutes applying to petroleum or natural gas do not contain the proviso "except as hereinafter provided" as shown above for mines.
- c. Statutes applying to petroleum or natural gas use the term "operator" rather than "mine operator" as shown above for mines.

No moneys invested in mines or improvements shall be allowable as a deduction unless all machinery, equipment and buildings represented by such moneys shall be returned to the county assessor of the county in which such mine is located for assessment purposes, at the level of assessment of all other property in such county.

No provision.

No money invested in the mine and improvements during any year, except the year for which such statement is made, and except as hereinbefore provided in this section, shall be included in such expenditure; and such expenditures shall not include the salaries or any portion thereof, of any person or officer not actually engaged in the working of the mine or superintending the management thereof.

Same d

d. Statutes applying to petroleum or natural gas substitute the phrase "except as provided in section 84-6204" for the phrase "and except as hereinbefore provided in this section" shown above for mines.

APPENDIX D

Net Proceeds Taxes On Oil Production

County	1. Production (Barrels)	2. Net proceeds Tax	3. Royalty Tax	4. Net proceeds tax per barrel (cents)	5. Royalty tax per barrel (cents)	6. Total tax per barrel (cents)
Big Horn	58,343	\$ 771.03	\$ 1,480.60	1.322	2.538	3.859
Blaine	190,832	193.74	4,208.05	0.102	2.205	2.307
Carbon	3,743,823	595,815.32	55,975.95	15.915	1.495	17.410
Carter	19,026	187.61	None	0.986	None	0.986
Daniels	7,313	None	498.31	None	5.447	5.447
Dawson	2,130,763	303,251.92	54,086.87	14.232	2.538	16.770
Fallon	7,456,376	559,761.84	94,027.18	7.507	1.261	8.768
Garfield	42,445	6,553.88	693.77	15.441	1.634	17.075
Glacier	2,425,819	264,995.40	94,205.23	10.924	3.883	14.807
Liberty	127,280	5,826.65	3,061.01	4.578	2.405	6.983
McCone	230,226	34,138.34	7,224.20	14.828	3.138	17.966
Musselshell	1,689,074	190,948.65	47,780.56	11.305	2.829	14.134
Petroleum	176,610	14,430.92	3,363.36	8.171	1.904	10.075
Pondera	370,600	25,891.29	11,460.44	6.986	3.092	10.079
Prairie	595,352	68,269.95	9,551.53	11.467	1.604	13.072
Richland	42,740	None	1,904.55	None	4.456	4.456
Roosevelt	2,767,346	524,673.59	80,642.99	18.959	2.914	21.874
Rosebud	3,013,954	304,585.65	62,070.65	10.106	2.059	12.165
Sheridan	1,435,861	197,253.41	52,893.79	13.738	3.684	17.421
Teton	220,831	12,804.44	8,944.56	5.798	4.050	9.849
Toole	770,855	47,804.26	37,922.52	6.201	4.920	11.121
Wibaux	3,482,371	242,394.31	42,967.93	6.961	1.234	8.194
Yellowstone	272,390	36,896.15	9,244.73	13.545	3.394	16.939
TOTALS	31,270,230	\$3,437,448.35	\$684,108.78	10.99*	2.19*	13.18*

* Weighted average for the state.

APPENDIX E

_____ Bill No. _____

Introduced By _____

A BILL FOR AN ACT ENTITLED: "AN ACT TO SUBMIT TO THE ELECTORS OF MONTANA AN AMENDMENT TO THE MONTANA CONSTITUTION PERMITTING THE LEGISLATIVE ASSEMBLY TO EXEMPT FROM PROPERTY TAXATION HOUSEHOLD GOODS AND FURNITURE, WEARING APPAREL AND OTHER PERSONAL PROPERTY USED BY THE OWNER FOR PERSONAL AND DOMESTIC PURPOSES."

BE IT ENACTED BY THE LEGISLATIVE ASSEMBLY OF THE STATE OF MONTANA:

Section 1. Section 2, Article XII of the Montana constitution is amended to read as follows:

"Sec. 2. The property of the United States, the state, counties, cities, towns, school districts, municipal corporations and public libraries shall be exempt from taxation; and such other property as may be used exclusively for the agricultural and horticultural societies, for educational purposes, places for actual religious worship, hospitals, and places of burial not used or held for private or corporate profit, institutions of purely public charity and evidences of debt secured by mortgages of record upon real or personal property in the state of Montana, may be exempt from taxation. *The legislative assembly may exempt from property taxation household goods and furniture, wearing apparel and other personal property used by the owner for personal and domestic purposes.*"

APPENDIX F

_____ Bill No. _____

Introduced By _____

A BILL FOR AN ACT ENTITLED: "AN ACT TO SUBMIT TO THE ELECTORS OF MONTANA AN AMENDMENT TO THE MONTANA CONSTITUTION PERMITTING THE LEGISLATIVE ASSEMBLY TO EXEMPT FROM PROPERTY TAXATION MONEYS, CREDITS, BONDS AND STOCKS."

BE IT ENACTED BY THE LEGISLATIVE ASSEMBLY OF THE STATE OF MONTANA:

Section 1. Section 2, Article XII of the Montana constitution is amended to read as follows:

"Sec. 2. The property of the United States, the state, counties, cities, towns, school districts, municipal corporations and public libraries shall be exempt from taxation; and such other property as may be used exclusively for the agricultural and horticultural societies, for educational purposes, places for actual religious worship, hospitals and places of burial not used or held for private or corporate profit, institutions of purely public charity and evidences of debt secured by mortgages of record upon real or personal property in the state of Montana, may be exempt from taxation. *The legislative assembly may, in its discretion, provide for the taxation or exemption from taxation of moneys, credits, bonds and stocks.*"

APPENDIX G

Bill No. _____

Introduced By _____

A BILL FOR AN ACT ENTITLED: "AN ACT AMENDING SECTION 84-406, R. C. M. 1947 TO PROVIDE FOR THE ASSESSMENT OF LIVESTOCK BEING FED IN FEEDING PENS OR ENCLOSURES ON AN AVERAGE INVENTORY BASIS RATHER THAN THE FIXED ASSESSMENT DATE OF THE FIRST MONDAY IN MARCH."

BE IT ENACTED BY THE LEGISLATIVE ASSEMBLY OF THE STATE OF MONTANA:

Section 1. Section 84-406, R. C. M. 1947 is amended to read as follows:

"84-406. When assessment to be made—credits must be assessed, how. *Livestock being fed in feeding pens or enclosures assessed on average inventory basis.* (1) The assessor must, between the first Monday of March and the second Monday of July in each year, ascertain the names of all taxable inhabitants, and assess all property in his county subject to taxation, except such as is required to be assessed by the state board of equalization, and must assess such property to the persons by whom it was owned or claimed, or in whose possession or control it was at twelve o'clock M. of the first Monday of March next preceding, except that such procedure shall not apply to

- (a) Motor vehicles which are required by subdivision (2) hereof to be assessed as of the first day of January; but no mistake in the name of the owner or supposed owner of real property renders the assessment thereof invalid.
- (b) *Livestock being fed in feeding pens or enclosures which are required by subdivision (3) of this section to be assessed on an average inventory basis.*

Credits must be assessed as provided in section 84-101, subdivision 6.

(2) The assessor must ascertain and assess all motor vehicles in his county subject to taxation as of January 1st in each year, and the same shall be assessed to the persons by whom owned or claimed, or in whose possession or control such vehicle was at twelve o'clock M. of the first day of January in each year. Nothing herein contained shall relieve the applicant for registration or reregistration of any motor vehicle so assessed or subject to assessment of the duty of paying taxes thereon as a condition precedent to registration or reregistration in the event said taxes have not been paid by any prior applicant or owner in all cases where required to be paid.

(3) *The assessed value of livestock being fed in feeding pens or enclosures on the first Monday in March shall be computed by adding the value of livestock more than six months of age being fed on the last day of each month since the last assessment date and dividing the sum by twelve."*

APPENDIX H

Summary of Information Gathered At Public Hearings

Because every person has a vital interest in property taxes, the Council property classification subcommittee held a series of public hearings to allow every person, firm, and association in the state an opportunity to comment on the property classification law. During the period September, 1963 through February, 1964, four public hearings were held. In addition to extensive public notice through news media, about seventy persons, firms, and associations were notified of the hearings directly by mail. Moreover, opinions were solicited from taxpayers and also from taxing officials—county commissioners and the State Board of Equalization. The Council believes that every reasonable effort was exerted to obtain comments and recommendations from all groups and persons in the state.

The Montana Petroleum Association stated that the classification law is inequitable and that the administration of property tax laws, particularly through assessment procedures used, produces even more inequities. Procedures for assessment were called a "hodgepodge" of sanctioned and unsanctioned extra-legal evaluations varying not only between counties but also within counties. The major reason for these inequities was said to be the failure to comply with statutes requiring assessment of all property at full cash value. The present classification law was said to be the principal reason that Montana's tax laws do not meet theoretical requirements of a reasonable property tax.

Rocky Mountain Oil and Gas Association asserted that taxes on the petroleum industry are inequitable and discriminatory, that Montana taxes are excessive and higher than in competitive states, that continued excessive taxation can retard oil development thus reducing the potential tax base of the state, and that industry is being penalized severely due to the lack of equalization. Montana taxes on the petroleum industry were said to be higher than any other state except possibly Louisiana. It was asserted that high taxes divert investment capital to other Rocky Mountain states. The most important of the several taxes on the petroleum industry was said to be the net proceeds tax, and this tax made Montana non-competitive for investment capital. Because statutes do not permit the deduction of many production costs, the net proceeds tax was said to be more nearly a gross production tax. The net proceeds tax was said to impose an excessive burden on the Montana petroleum industry as compared with other Montana industries and also as compared with the petroleum industry in other Rocky Mountain states.

Representatives of county commissioners of Fallon, Musselshell, and Roosevelt counties opposed any reduction in net proceeds taxation of petroleum production. They asserted that many services were supplied to petroleum producers before any appreciable amount of revenue was received from net proceeds taxation. A distinction was also drawn between petroleum production which is taxed only once and the annual taxation of other property. Commissioner representatives also noted that a reduction in net proceeds taxation would have a marked effect on taxes levied on other property.

The Billings Chamber of Commerce asserted that present taxation of the petroleum industry is excessive when compared to other states. To the extent that this taxation makes Montana non-competitive, development of the petroleum industry is retarded. Anaconda Company asserted that net proceeds taxation in Montana is discriminatory. The classification law should set taxation of mineral production at two and one-half times taxation of the next highest class of property. Due to fractional assessments and the classification law, actual taxable values in Montana are two and eight-tenths, eight, twelve, thirteen and one-third, and sixteen percent; but net proceeds remains at one hundred percent. Net proceeds,

therefore, assumes not two and one-half times the burden of the next highest class of property, but rather six times—substantially more than was originally intended. Zonolite Division of W. R. Grace and Company asserted that net proceeds taxation works an injustice on the mining industry. And, a private petroleum consultant stated that equality in taxation would never be achieved until the classification system is abolished.

Montana Farmers Union advocated changes in the classification law that would more clearly distinguish between income and non-income producing property and possibly regroup the present seven classes into four classes. A distinction should be drawn between foundation herds and livestock raised for immediate sale. In addition to changing the present property classes, the Farmers Union recommended assessment of property uniformly at either full market value or a percentage of full market value. Closer cooperation between state and local taxing authorities was also urged.

Montana Stockgrowers Association stated that it would be unwise to amend the classification law piecemeal, but the law has become so antiquated there is little reason for its existence. Better assessment and equalization should be the primary goal, and then correction of the law. Livestock are not standardized, and values vary widely between herds. Stockgrowers stressed the need for adequate research to determine the tax burden on each class of property, and agreed that an average inventory assessment for feeder livestock would be desirable.

The Montana Railroad Association asserted that properties assessed by the State Board of Equalization were valued at a higher ratio to full market value than other properties, and in some cases were valued in excess of present value. The railroads have no quarrel with fractional assessment as long as the same percent of true and full value is used for all property. Railroads recommended changes that would either: (1) repeal the classification law and require assessment of all property at a uniform percentage of value, or (2) place all real estate regardless of ownership in the same class and assess it at the same percentage of full value and provide that railroad personal property (including equipment) be taxed like similar personal property of other corporations.

Montana Power Company noted inequities between taxation of investor-owned and cooperative electrical associations. The company suggested that if the classification law is not repealed, present discrimination under it should be eliminated. Montana Associated Utilities recommended that rural electric cooperatives be taxed on the basis of four percent of assessed value (one-tenth of the rate applied to other utilities); or, in the alternative, that investor-owned utilities be taxed at seventy percent of value rather than the present forty percent (ten times the seven percent rate now applied to rural electric cooperatives). Fergus Electric Cooperative noted the difference between consumers on cooperative and investor-owned electric utilities, but made no specific recommendations.

Rocky Mountain Oil and Gas Association, representing owners of petroleum pipelines, recommended repeal of the classification law. Assessment of all property at a uniform percent of full value was advocated.

The Montana Bankers' Association asserted that banks are the only property placed on the assessment rolls at full value creating an inequity in taxation. Any proposed change in the classification law should consider the value of what banks in the state have done by increasing capital accounts resulting in greater assessed values and hence more taxes paid. It was said that the 1957 amendment to the classification law has benefited both the state and bank depositors.

Representatives of county commissioners recommended that the net proceeds law be left unchanged. They stated there was merit in exempting moneys and solvent credits, and also

agreed that taxing household goods and similar personal property at a percentage rate based on the value of real property had merit. A private individual recommended that all unenforceable taxes be repealed and generally agreed that household goods and intangible personal property should be exempt from ad valorem property taxation.

The State Board of Equalization recommended that their department have additional qualified staff personnel for property tax administration. The chairman of the Board indicated he would favor leaving present laws unchanged, and also agreed there is merit in removing the constitutional status of the Board and establishing a single appointive administrator retaining a board for policy and quasi-judicial functions.



